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HOW TO MAKE AN AMERICAN JOB

BY ANDY GROVE

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Opening Remarks



Who Would Bet Against John Paulson?

Paul Krugman would. The hedge fund wizard is wildly bullish, while the economist is forecasting pain. The gods can only reward one. By Hugo Lindgren

History will show that the week before the nation's 234th birthday, Paul Krugman, Nobel Laureate and professor of economics at Princeton University, went all in on Keynesian orthodoxy. To regular readers of his column in *The New York Times*, this was not a surprise. Since the financial crisis began, Krugman has been adamant that the federal government must fearlessly run up deficits to compensate for weak private spending and keep the U.S. economy from death-spiraling into deflation.

Now his warnings have taken on an even more dire tone. The threat is not merely the dreaded "double dip." If the leaders of the developed world hold to pledges they made at the G-20 summit in Toronto and cut government spending, Krugman argues, we face nothing less than a "third depression"—perhaps not as singularly devastating as the Great Depression, which ripped the U.S. economy in half, but comparable to the Long Depression that followed the Panic of 1873, a grinding period of chronic social need and dissension.

If that makes you want to head for the hills with your shotgun and turnip seeds, consider another view, expressed the week prior at the London School of Economics. The speaker was not a decorated academic with visions of 1873, he was a profit seeker, pure and simple: John Paulson, the hedge-fund manager on whose behalf Goldman Sachs cooked up those killer collateralized debt obligations designed to pay off handsomely in the event of a housing crash. He was right about that one, you'll recall.

"We're in the middle of a sustained recovery in the U.S.," Paulson declared in London. "The risk of a double dip is less than 10 percent." The housing market is now, he says, an attractive buying opportunity. "It's the best time to buy a house in America," he said. "California has been a leading indicator of the housing market, and it turned positive seven months ago. I think we're about to turn a corner."

No mention of a third depression.

Paulson's bullishness is not new. Last spring, when Krugman was arguing that some major U.S. banks ought to be nationalized, wiping out equity holders, Paulson was busy building a massive stake in Bank of America. He and Krugman may not have disagreed about the fundamental health of the banking business—they just disagreed about what it meant. Paulson wasn't buying banks because he liked their second-lien books; instead, he had grasped that the Swedish-style takeover Krugman advocated was not going to happen, and that a tacit federal backstopping of the banking industry took most of the risk out of going long.

With the American taxpayer covering his downside, investing in U.S. financial institutions was easy pickings. Paulson's latest 13f filing with the Securities & Exchange Commission, which records his holdings as of Mar. 31, indicates

FROM LEFT: RICK MAIMAN/BLOOMBERG/GETTY IMAGES; BRIAN ZAK/SIPA PRESS



nearly $2.995 billion of Bank of America common stock and $2.052 billion of Citigroup common. Despite healthy advances from their spring 2009 lows, banks may have more room to run, particularly if Paulson is correct in the estimate he made to investors, according to *The Wall Street Journal,* that housing prices will rise as much as 10 percent next year.

Since his initial forays in banks, Paulson has ventured into riskier assets like casino stocks and vacant residential land in the utterly busted Florida and Southern California markets. As a private hedge fund manager, Paulson is not obliged to provide a complete picture of his investments; long positions could be hedged with shorts and derivatives that he does not have to divulge. But nothing in either his statements or reports about what he's buying suggests he is anything less than upbeat about the economy right now.

Some positive currents seem to be gathering force beneath the choppy stock market. U.S. credit-rating upgrades on corporate bonds exceeded downgrades this quarter for the first time since before markets froze, according to Bloomberg News. "I do see more upgrades coming," says Ann Benjamin, chief investment officer of leveraged asset management strategies

"It's the best time to buy a house in America," says Paulson. "I think we're about to turn a corner"

Paulson (left) and Krugman have dueling outlooks for the health of the economy

at New York-based Neuberger Berman, where she helps oversee $7.5 billion of high-yield bonds and $5 billion of loans. "There's plenty of good companies out there that may be misrated."

Krugman, by contrast, sees darker forces at work. He argues that the market has already ratified his belief that fiscal tightening will smother the recovery, pointing to widening bond spreads in Greece and Ireland, where huge cuts loom. About Ireland, Krugman recently wrote on his *Times* blog, "All that savage austerity was supposed to bring rewards ... But the reality is that nothing of the sort has taken place: virtuous, suffering Ireland is gaining nothing." The markets have been kinder to Spain, he says, because leaders there have cut less.

The heart of the matter, for Krugman, is unemployment. As long as it remains at such elevated levels, he says, more and more people remain out of work for so long they become unfit to hold jobs.

It's hard not to marvel at Krugman's conviction about how all the pieces fit together, why it's essential to mankind that Germany start spending and China let the value of its currency appreciate. If the world economy had a cockpit, Krugman exudes the confidence of a man who could climb in there, flip all the right switches, and get this sucker airborne.

Paulson has a simpler view: Americans are starting to spend again, in ways not terribly dissimilar to the ways we did before, buying suburban homes and stuffing our Social Security checks into slot machines. There are pitfalls. As we work our way back to the old normal and demand picks up, the years of superlow interest rates will come back to smack us, fueling inflation that Paulson sees possibly reaching into the double digits within a few years. That's why, in addition to Florida property, Paulson is heavily invested in gold.

As Gregory Zuckerman described in *The Greatest Trade Ever,* Paulson rose from obscurity by exploiting the age-old tendency of investors in flush times to blithely assume risks they don't understand, like buying the other side of his bespoke CDOs. Now he has flipped, betting that investors are so gun-shy they can't quantify the potential for upside. Recent tremors in the stock market bring flashbacks of fall 2008 and the nerve-racking question: Is this the big one?

The debate over the economy can be thought of as a trade—Paulson taking one side, Krugman the other. Paulson's got real money on the table, but for both men, the main risk is reputational. Is Paulson another Wall Street one-hit wonder? Is Krugman another too-smart-for-his-own-good academic with no feel for animal spirits? Paulson may have an edge because he is just playing the market. Krugman is playing history, which is quite a bit trickier. B

—Additional reporting by John Glover and Sapna Maheshwari

It's greener in more ways than one.

The Airbus A380 has earned its reputation as the world's greenest long-haul jet. But it's been earning hard dollars at the same time. The moment it entered service, its sheer popularity, combined with the lowest cost per passenger of any large aircraft, has meant more profit, much quicker. Giving its operators a competitive edge in tough times. Simply by introducing A380s on long-haul routes, operators can save millions of dollars a year in cash operating costs, while creating thousands of extra seats. The most exciting plane in the sky is also a proven, working aircraft, making real money, day after day. **Airbus A380. See the bigger picture.**



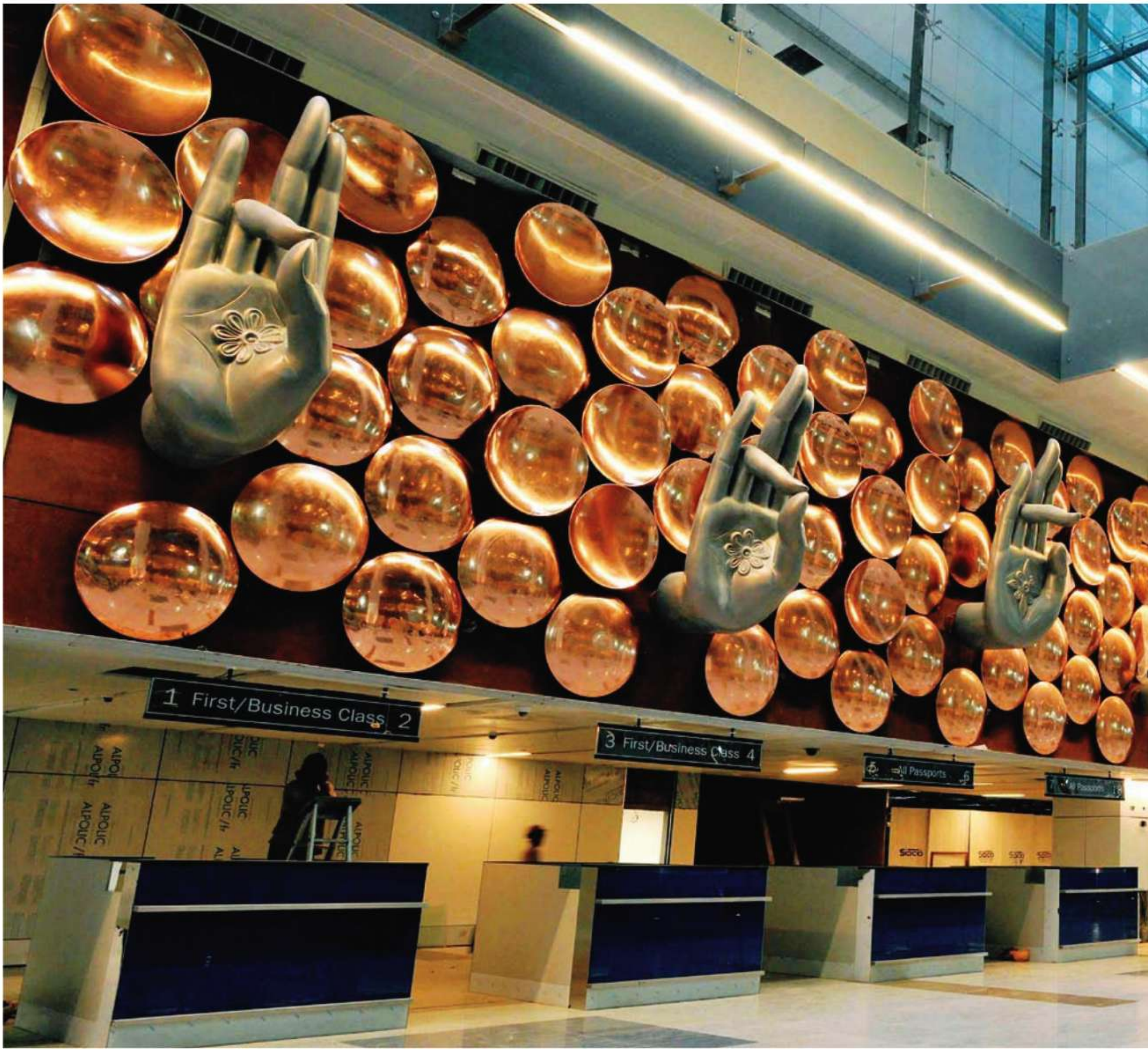
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Global Economics



Finally, a Modern Passage to India

▶ New Delhi gets a terminal worthy of Hong Kong or Dubai

▶ "For the first time, we will have a world-class hub"

On July 14 passengers on international flights to and from New Delhi will no longer walk through the overcrowded building that has been the capital's gateway to the world for 24 years. Instead, they will enter a terminal designed by London architects **HOK International** that is encased in sheets of glass etched with images of Indian dancers. With 78 gates, 97 automated walkways, 95 immigration counters, 215,000 square feet of retail space, and parking for 4,300 cars, the building is comparable to the modern aviation hubs of Hong Kong,



Delhi's new terminal and other renovations cost $2.2 billion

RAKESH SAHAI

Singapore, and Dubai. "For the first time, we will have a world-class hub," says Binit Somaia, Sydney-based director for South Asia at the Centre for Asia Pacific Aviation (CAPA).

The terminal, which with other renovations cost $2.2 billion, is a sign that India may be turning the corner on solving one of its most intractable problems: a notoriously poor infrastructure. The terminal took only 37 months to build. That's faster than the 45 months China spent to complete the terminal in Beijing that opened in time for the 2008 Olympics. By creating a new benchmark for completing major projects, "the Delhi airport is going to transform India," says T.V. Mohandas Pai, head of human resources at Infosys.

India spends 6.5 percent of its gross domestic product on infrastructure, vs. 11 percent in China, according to consultants Ernst & Young, and its undeveloped roads, power plants, and ports have limited growth. The average turnaround time for ships unloading and loading cargo at India's major ports is 3.8 days; in Hong Kong it's 10 hours. The delays at airports have an impact, too. When trying to persuade companies to put money into India, "You don't want foreign investors to get stuck behind immigration lines for two and a half hours," says Jahangir Aziz, India chief economist at JPMorgan Chase. New Delhi's old airport definite-

New airports have been built in Bangalore and Hyderabad, hubs for the IT and pharma industries



Mexico: Donovan cashes in page 22▶

ly has affected the economy, says Rahul Bajoria, an economist in Singapore with Barclays Capital. “Beijing and Shanghai have fabulous airports, and they are much more linked to the global economy than Delhi is,” he says.

The government of Prime Minister Manmohan Singh has focused airport projects on the cities investors are most likely to visit. New airports already are operating in Bangalore and Hyderabad, the hubs for India’s IT and pharma industries. Passengers can now fly easily from Bangalore to Singapore; before, they often had to waste hours connecting through Chennai. “Foreign companies can come to Bangalore on shorter notice now,” says Manan Bhatt, senior vice-president for external relations at **Avesthagen**, a Bangalore biotech. “The improved connectivity is a very attractive proposition.” Due next for an upgrade is Mumbai, the financial capital, which will get a new terminal in 2012.

The price tag to expand and upgrade Indian airports by 2020 is likely to be $20 billion, says CAPA. With the government estimating that more than $1 trillion must be spent on ports, roads, utilities, and other infrastructure, Singh and his ministers are cooperating with private companies for funding and knowhow. The Delhi terminal was built by a private-public consortium overseen by builder GMR Group. Last year a special cabinet panel headed by Singh was set up to accelerate infrastructure investments.

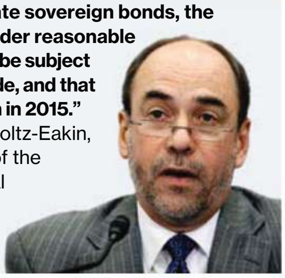
Still, bureaucracy remains a problem. Of the 618 big infrastructure projects monitored by the government, 323 were behind schedule as of Mar. 1, some by as long as 60 months. That has led to $12.3 billion in cost overruns.

Fraport is a German company that operates Frankfurt Airport, one of the world’s busiest. Its Indian business, which includes a stake in the consortium managing the Delhi terminal, hopes to operate other airports the government promises to privatize. “None of those projects has materialized,” says Ansgar Sickert, head of Fraport in India. “We are not clear where the opportunities really lie in India.” More projects like Delhi may clarify things.
—Subramaniam Sharma and Vipin V. Nair, with Bruce Einhorn

The bottom line *India’s government has made big strides in infrastructure with its new airports. Red tape, however, needs cutting fast.*

Quoted

“I did some arithmetic that suggested if you look at the criteria that Moody’s employs to rate sovereign bonds, the U.S. would under reasonable assumptions be subject to a downgrade, and that would happen in 2015.”
—Douglas Holtz-Eakin, former head of the Congressional Budget Office



Taxes

Coping with Australia’s Two Economies



▶ A challenge to mining giants topples a Prime Minister

▶ “We’re going broke by the minute,” says one wheat grower

Australian Prime Minister Kevin Rudd faced off against the mining companies—and lost. In May, Rudd, a Labor Party PM, proposed a 40 percent tax on mining income to slow the industry’s runaway growth in Australia, the world’s largest exporter of coal and iron ore. Rudd also wanted tax cuts for non-mining companies in an effort to redistribute profits and rebalance growth in the economy. What he got was a bitter battle between the Australians who benefit from the mining boom and those who don’t.

The resistance to the mining tax was so intense that Rudd had to step down as Prime Minister on June 24. His successor, Julia Gillard (above), who was Rudd’s Deputy Prime Minister, now says she will negotiate with the mining companies—which include giants like **BHP Billiton** and **Xstrata**—over any possible tax instead of locking horns with them.

While Gillard, the country’s first female PM and a lawyer, has calmed the political scene temporarily with deft diplomacy, the underlying problem Rudd was trying to address remains. Chinese demand for metals and energy is pitting resource-rich Western Australia and companies like BHP Billiton and Xstrata, which have a combined $74 billion in revenue, against the rest of the country. Coal and metal sales to China have grown so fast that the mining sector has driven up demand for labor and funds to expand the mines further. As upward pressure on prices has increased, the central bank governor, Glenn Stevens, has raised interest rates six times in seven months.

The rate hikes have helped drive the Australian dollar up 21 percent since early 2009. The rise has not had a major effect on the miners’ exports to China, which still hungers for raw materials. Yet for other exporters, like wheat farmer John Springbett, the dollar’s rise hurts. “We’re going broke by the minute,” says Springbett, who ships 4,000 tons of grain a year to India, Indonesia, and the Middle East from his farm east of Perth. Springbett says when the Australian dollar rises above 70¢ (U.S.), it puts many farmers in the area at risk. (It’s near 85¢ now.) “Last year most farmers would have made a loss,” he says. “We don’t want another one of those years. Otherwise there will be a lot of farms for sale.” The government figures wheat exports dropped 21 percent in the 12 months through June 30.

The domestic economy is showing the strain, too. Workers now flock to higher-paid jobs in regions such as the Pilbara, the remote north of western Australia and source of one-third of the world’s iron ore. Mining wages eclipsed the earnings of staff at Australian banks, brokers, and insurers by 35 percent in February, according to the Bureau of Statistics. Mining workers earn an average of $1,685 a week, well above the $1,250 average in the financial sector.

In the snowy mountain town of Tumbarumba, 310 miles southwest of Sydney, **Hyne & Son**, the Southern Hemisphere’s largest softwood timber mill, is short of electricians, wood machinists, and clerical staff,

Acts of God

Weather and the Economy

The formation of a tropical storm in the Gulf of Mexico raised fears it would turn into a hurricane, then bear down on key oil-producing areas and disrupt the flotilla of BP-financed ships trying to stop the Deepwater Horizon leak. The episode is a timely reminder of how much weather still matters in business. Here are some parts of the world where weather can have a dramatic effect on inflation, GDP growth, and more.



Brazil



The rains were especially heavy this year, which damaged vegetable crops in the state of São Paulo, Brazil's breadbasket, and sparked a jump in food prices. Now the rainy season is ending, and farmers expect a healthier harvest. Investors are counting on inflation to ease as a result. Food and beverages account for 23 percent of Brazil's consumer price index, the largest component in the CPI.

The Pacific



The world's biggest ocean spawns El Niño, a prolonged period of above-average water temperatures off the west coast of Latin America, and La Niña, a period of colder-than-average water. Both systems have an effect on rainfall in Latin America—the heavy Brazilian rains that affected inflation stemmed from El Niño's appearance last year. Now, La Niña has emerged. Its impact on high-altitude winds will trigger more hurricanes in the Gulf.

China



Historically, major river floods have plagued China and have been critical to the success or failure of the farm economy. Farming's share of GDP has sharply diminished. Yet floods and droughts continue to have a direct impact on hydroelectric power, which is a key part of China's economic plan.

Gulf of Mexico



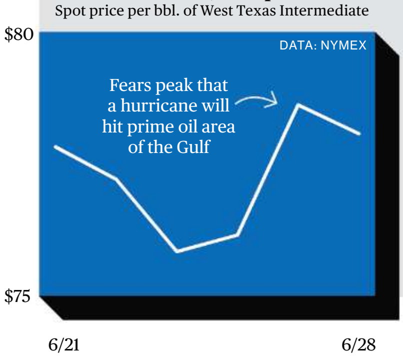
The National Oceanic & Atmospheric Administration predicts an active hurricane season this year, with 14 to 23 named storms and 8 to 14 actual hurricanes. The storms, which form off West Africa, can shut down oil production in the Gulf, causing oil prices to spike. On June 25 the price of crude jumped 3 percent on fears of an early start to the hurricane season.

India

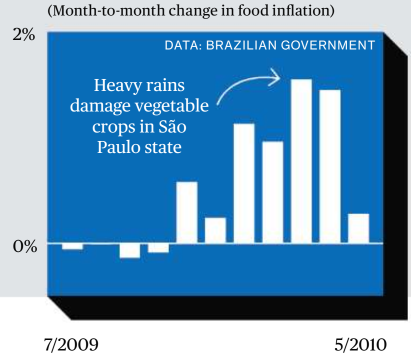


The annual monsoon rains, which just began off the southwest coast near India's Kerala state, are critical to agriculture, which accounts for almost 20 percent of Indian GDP. If Indian farmers can't increase output, the government will have to import grain and vegetable oil, which will worsen inflation. This year's monsoon season is already delivering more rain than the poor monsoon of 2009, the worst in decades.

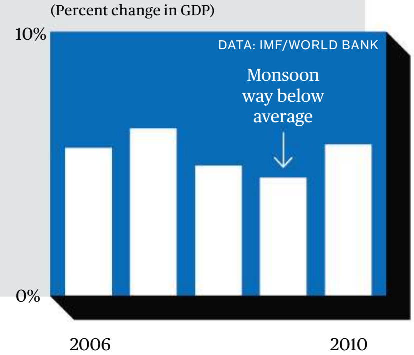
Hurricane Fears, Oil Spikes
Spot price per bbl. of West Texas Intermediate



Brazil and Food
(Month-to-month change in food inflation)



India GDP and the Monsoon
(Percent change in GDP)



CLOCKWISE FROM TOP LEFT: SIMON BRUTY/SPORTS ILLUSTRATED/GETTY IMAGES; GERARDO GARCIA/REUTERS; CHIP SOMODEVILLA/GETTY IMAGES; MICK TSIKAS/REUTERS

the local shire council told Parliament in April. "It's very much a two-speed economy that's emerging," says Saul Eslake, an economist at the Melbourne-based Grattan Institute, a nonpartisan state-supported research group.

BHP and Xstrata have both warned that if the 40 percent tax goes through unaltered, they will probably divert investments to mines outside Australia. Some local economists like Eslake, though, say less mining investment may be beneficial, since it would cool off growth and let the central bank stop hiking rates. "From the viewpoint of the whole economy, the best thing that could happen is for one of the big [mining] projects to fall over," central bank Deputy Governor Ric Battellino said, according to a May 11 report in *The Australian Financial Review*, the business daily. The central bank would not comment.

Gillard must heal the split in the economy even as China's purchasing power expands. The wider trading band for the yuan means a stronger Chinese currency. That could translate into even more demand for Australian coal and iron ore—and strengthen the Australian dollar further. A boon for some, more hardship for others.

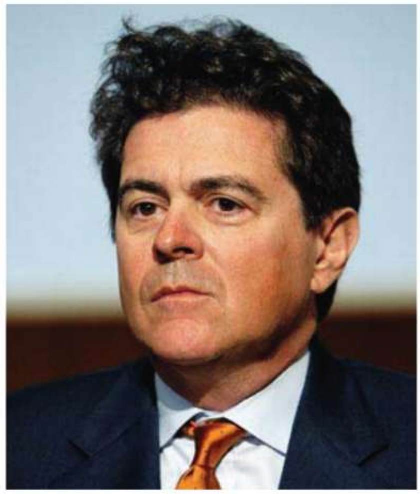
—*Jacob Greber and Robert Fenner*

The bottom line *Australia's new Prime Minister must avoid alienating the mining sector while shoring up the rest of the economy.*

52.9

June reading for the Conference Board's consumer confidence index. That's worse than expected: The May reading was 62.7. A high jobless rate spooked Americans, while the states exposed to the Gulf oil spill showed steep declines in confidence.

DATA: THE CONFERENCE BOARD



LUCAS SCHIFRES/BLOOMBERG

Fiscal policy

Keynes vs. Alesina. Alesina Who?

▶ Economist Alberto Alesina argues that austerity triggers growth

▶ "'I don't see how anyone can say we should push on the accelerator."

Alberto Alesina is a new favorite of fiscal hawks like former President George W. Bush's chief economic adviser, N. Gregory Mankiw. A professor of economics at Harvard University, the 53-year-old Italian (above) disputes the need for more government spending to prop up growth and advocates spending cuts instead.

This is Alesina's hour. In April in Madrid, he told the European Union's economic and finance ministers that "large, credible, and decisive" spending cuts to reduce budget deficits have frequently been followed by economic growth. He backed his proposal with historical research on rich countries' experiences since 1980. Later, at the Group of 20 summit in Toronto on June 26-27, the presidents and prime ministers of the advanced economies agreed to shrink their budget gaps by half or more by 2013. That put pressure on President Barack Obama to follow the lead of cost-cutters such as Britain's Chancellor of the Exchequer, George Osborne, and German Chancellor Angela Merkel. Says Alesina: "I think the Germans are right."

Alesina argues that austerity can stimulate economic growth by calming bond markets, which lowers interest rates and promotes investment. In addition, he says, deficit-cutting reassures taxpayers that more wrenching fiscal adjustments won't be needed later. That revives their animal spirits and their spending. Alesina says that as a way to shrink deficits, spending cuts are better for growth than raising taxes. The Madrid paper, a summary of his views, was influential enough to be cited in the official communiqué of the EU finance ministers' meeting.

Alesina's historical research, though, doesn't shed much light on what might happen if the U.S. adopts an austerity budget, because current circumstances don't resemble most of those in Alesina's database. It's rare for a nation to suffer such a big shortfall in demand that it cuts interest rates to zero, as the U.S. has. It's even rarer for a government in such circumstances to tighten its fiscal belt. Japan's experience is a cautionary tale. Japan attempted to tackle its deficit in the late 1990s during a period of weak demand and near-zero rates. Many economists say the move prolonged the slump that became known as Japan's Lost Decade. To be sure, Japan tried to balance its budget mainly by raising taxes, which is not Alesina's preferred solution.

Economists who describe themselves as Keynesians or neo-Keynesians don't buy Alesina's medicine. Gauti B. Eggertsson, a staff economist at the Federal Reserve Bank of New York, concluded in a paper last November that, with interest rates at zero, the right remedy is to raise government spending, not cut it. Espousing his own views and not those of the Fed, Eggertsson wrote that when extremely loose monetary policy isn't stimulative enough, "the goal of policy should be to increase aggregate demand—the overall level of spending in the economy."

Alesina's own research shows mixed results from deficit-cutting. He identified 26 examples since 1980 of deficit reductions that triggered growth of gross domestic product and 21 that lowered government debt substantially. He found only nine double victories in which government policymakers managed both to expand their economies and reduce debt. (Among them: Ireland in 2000, and the Netherlands and Norway in 2006).

Alesina is unfazed. While acknowledging that experience with zero-rate

How fast does a system have to be to capture a business opportunity?

How do you cut costs without cutting results?

How do you benchmark intelligence?



situations is scant, he says, "I don't see how anyone can argue that we should push even more on the fiscal accelerator." He says the greatest risk to global growth is a financial crisis brought on by fears of government overindebtedness. Clearly, economists are as divided as politicians. The problem is that if austerity budgets are pursued and they prove ill-advised, many more people will suffer than just a few economists. *—Peter Coy*

The bottom line *Alesina has provided the theoretical ammunition fiscal conservatives want. The Keynesians say that his research does not apply.*

Compensation

In Japan, Underpaid—And Loving It

▶ New regulations reveal just how little Japanese chiefs earn

▶ "There's no market for executives," says one compensation expert

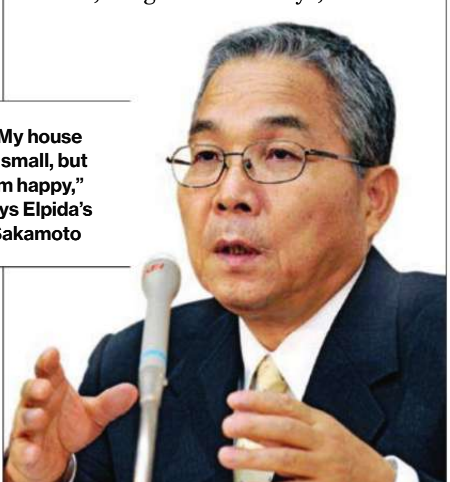
Japan is the land of the bargain-basement CEO. On June 30 securities regulators began requiring Japanese companies to disclose pay for executives making more than 100 million yen ($1.1 million). While the headlines went to the top earners—foreigners Carlos Ghosn of **Nissan Motor** and **Sony**'s Howard Stringer—the big surprise was how few Japanese business leaders take home super-size paychecks.

Although pay for Japanese executives has more than doubled in the past decade, the government says, fewer than 300 people at Japan's 3,813 public companies earned enough in 2009 to require disclosure, according to **PricewaterhouseCoopers**. Companies listed on Japan's stock exchanges paid their chief executives an average of $580,000 in salary and other compensation last fiscal year, PWC estimates, about 16 times more than the typical Japanese worker. Average CEO pay at the 3,000 largest U.S. companies is $3.5 million, including stock options and bonuses, according to the Corporate Library, a research group.

A drawback of Japan's low pay is that it's harder to recruit abroad because junior executives overseas can end up with higher salaries than their peers—or bosses—at headquarters. "They have to make a special case for hiring a VP who's making more than the president," says Motohiro Morishima, a professor of human resources at Hitotsubashi University. At **Takeda Pharmaceutical** in Osaka, the CEO takes home $2.5 million—half as much as the U.S. sales chief.

Most Japanese bosses have been hired from inside their companies. "There's no market for executives," says Kotaro Tsuru, a corporate governance expert at the Trade Ministry's research institute. "The reasonable price for a CEO is decided by each firm separately." Nissan's Ghosn, Japan's top-paid CEO, took home $10 million in 2009. Over at **Toyota Motor**, meanwhile, Chairman Fujio Cho earned $1.5 million. CEO Akio Toyoda wasn't among the four executives who received more than $1.1 million (though as the founder's grandson, he owns about $160 million in company shares). Sony's Stringer, Japan's second-highest-paid executive, made $9.1 million. At rival **Panasonic**, nobody earned enough to require disclosure under the new rules.

With wealth still considered unseemly in Japan, there's little pressure for salaries to rise. "My house is small, but I'm happy," says Yukio Sakamoto, CEO of **Elpida Memory**, Japan's largest semiconductor maker, whose pay was under the reporting threshold. "I commute by train every day and have never had a problem." *—Jason Clenfield, with Ian Katz*



"My house is small, but I'm happy," says Elpida's Sakamoto

The bottom line *Japan's CEOs earn far less than Americans or Europeans. The pay gap could be a problem as Japanese companies expand abroad.*

Tom Keene's EconoChat

Tom talks with **Ken Feinberg**, administrator of the $20 billion BP disaster victim compensation fund.

Suppose I have a shrimp boat, and I haven't been able to get out and catch any shrimp because of the oil spill. How do you calculate what I have coming to me?
First, it is very hard to calculate losses from a long-term business interruption as long as the leak continues. Once the leak stops, I will sit down with that shrimper. We will try and agree on a loss. I will offer a check. He can either take it or say "no, thank you" and litigate.

Ken, you did seminal work establishing just compensation for the victims of 9/11. Now give us a framework of how you establish that shrimper's check. Is it a net present value analysis of a 20-year work life?
You're not far off. I'll say, "Mr. Shrimper or Mrs. Shrimper, let's see what you have been doing in the past, pre-leak. Let's see what your tax returns or your profit-and-loss statements show. Let's try and agree on what the likely impact will be going forward."

What about my pain and suffering if I planned a vacation and I can't go to the beach?
No pain and suffering for a vacation loss. Also, don't forget the real challenge here is not the shrimper. It's that restaurant in New York City that says "Mr. Feinberg, I have the best shrimp scampi in the city, but I can't get Gulf shrimp now. I am losing business. Give me a check." How attenuated or indirect will you allow claims rising out of this spill? That is a challenge. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

FROM LEFT: KIMIMASA MAYAMA/BLOOMBERG; ANDREW HARRER/BLOOMBERG

Smarter business for a Smarter Planet:

It’s time to ask smarter questions.

What exactly does a benchmark mean? For the last five years, IBM DB2 has spent more time at the top of three of the industry’s leading performance benchmarks than Oracle and Microsoft combined. But is that the best way to think about the possibilities of technology? What really matters isn’t some abstract measure of performance, it’s what companies actually do with that performance. For instance, Globe Telecom is using a service delivery platform from IBM to increase their sales by 112%. EuResist is using an integrated analytics solution to predict the most effective drug combinations for individuals with HIV, with 78% accuracy. And CAIXA Econômica Federal, one of the largest banks in Latin America, is using a service oriented architecture to slash infrastructure acquisition costs by over $330 million. On a smarter planet, these are the benchmarks that matter.

A smarter business is built on smarter software, systems and services.
Let’s build a smarter planet. ibm.com/questions



1. Based on number of days of performance leadership for the TPC-C, TPC-H 10TB, and SAP 3-Tier SD benchmarks between June 1, 2005, and June 1, 2010. For more information, see http://www.tpc.org and http://www.sap.com/solutions/benchmark. TPC, TPC-C and TPC-H are trademarks of the TPC. IBM, the IBM logo, ibm.com, DB2, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2010.

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Please RSVP by visiting bloomberglink.com/gatherings.php or emailing Jeremy Lindblad at jlindblad@bloomberg.net

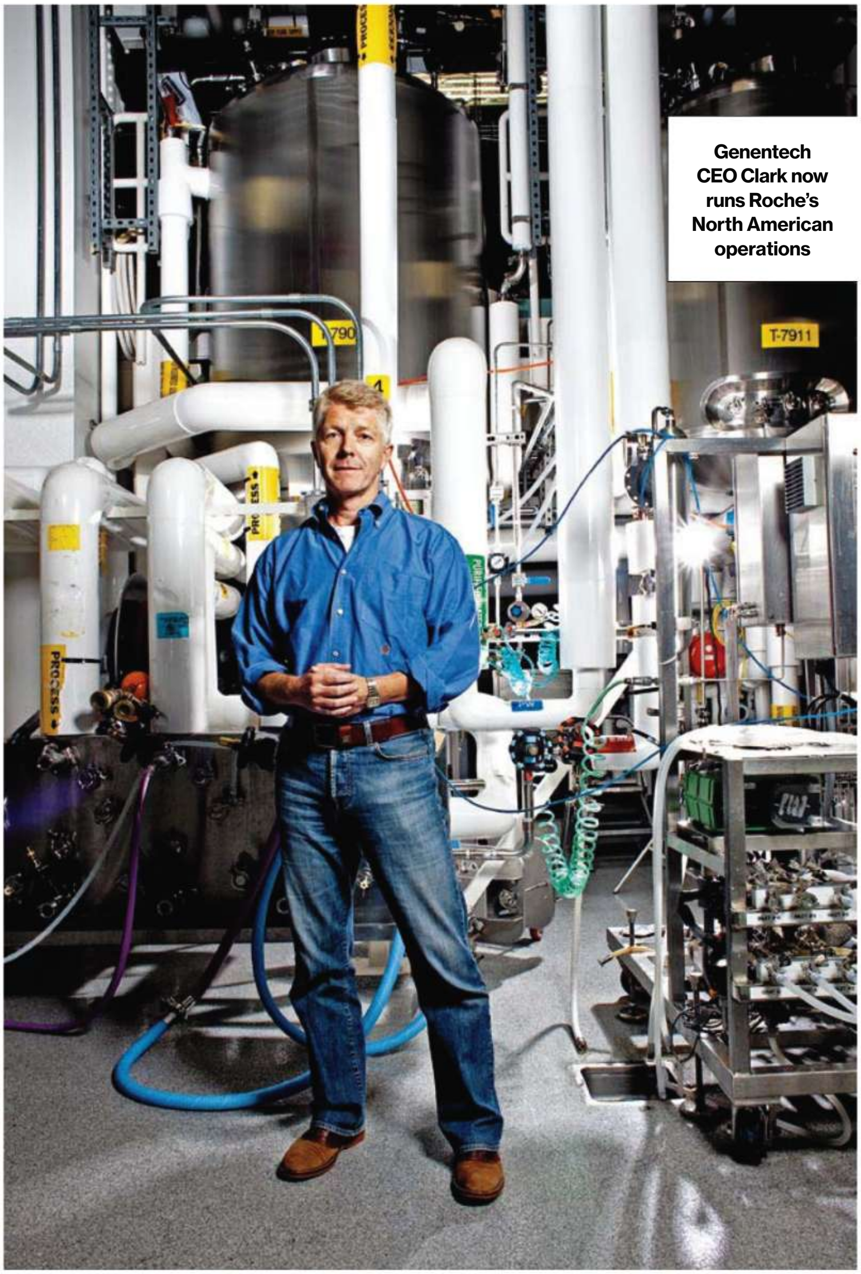
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Companies&Industries

Post-Buyout, Genentech's DNA Is Dominant

▶ **Bought out for $47 billion, the biotech pioneer has gained the upper hand**

▶ **"Success ultimately equates into power, and that's ... what we're seeing at Roche/Genentech"**



Genentech CEO Clark now runs Roche's North American operations

PHOTOGRAPH BY GABRIELA HASBUN FOR BLOOMBERG BUSINESSWEEK

When **Roche Holding** executives held an investor-day briefing in New York in March, Morgan Stanley analyst Andrew Baum had a question that had nothing to do with new drugs, licensing deals, or health-care legislation. "Did the Genentech team hide the ties of the Roche executives?" he asked. Richard H. Scheller, a veteran scientist at Genentech, the Silicon Valley biotechnology powerhouse Roche took over last year for $46.8 billion, quipped that he doesn't own one. Turns out his Roche colleagues on the stage, led by Chief Executive Severin Schwan, didn't want him to look out of place so they ditched theirs.

"I'd never seen them without suits and ties before," Baum said. To him, the informal attire "reflected the willingness of Roche to be seen to bend toward Genentech, rather than the other way around."

Genentech's impact on the Swiss drugmaker goes beyond the wardrobe of its executives. Unlike many acquired companies, the biotech leader is retaining its own culture even though it's under new ownership. Roche has placed Genetech scientists in key jobs, such as head of drug development for the combined company. The U.S. operations of Basel, Switzerland-based Roche bore the brunt of job cuts following the merger, and Genentech's research structure has been adopted across the company. Meanwhile, at Genentech's base—1 DNA Way in South San Francisco—employees say not much has changed.

"Success ultimately equates into power, and that's exactly what we are seeing at Roche/Genentech," said Jörg de Vries-Hippen, chief investment officer for European equities at Allianz Global Investors in Frankfurt. "Now that the full integration has taken place,

it's the Genentech guys being promoted and getting the key positions."

Besides the billions it spent to buy Genentech, Roche has another reason to handle the biotech company carefully: its lucrative cancer drugs. Three of Genentech's cancer therapies—Avastin, MabThera (sold in the U.S. as Rituxan), and Herceptin—together logged sales of 17.6 billion Swiss francs ($15.36 billion) last year, topping the revenue for Roche's 10 best-selling non-Genentech medicines. Genentech generated revenue per employee of $1.2 million in 2008, compared with $527,664 at its Swiss parent, according to data compiled by Bloomberg.

Wall Street analysts now tie Roche's future to Genentech's continued success. "Roche's long-term sales growth is better than its peers mainly due to a subsidiary that's been churning out its key blockbusters, while its own research unit hasn't been as productive," said Carri Duncan, an analyst at Macquarie Group in Zurich. "It appears to be a case of, 'If you can't beat 'em, join 'em.' "

That's certainly true in Roche's executive ranks. Genentech's Hal Barron, a 14-year veteran, is now head of Roche global development. Genentech CEO Ian Clark heads Roche's North American commercial operations. Pat Yang, who joined Genentech in 2004, moved to Basel to run global manufacturing. Scheller took a seat on Roche's 12-member executive committee.

Roche CEO Schwan said the shake-up of research led to initial uncertainty, particularly in Basel. Also, for the "first time ever in our history of acquisitions or mergers," global-management positions moved from Switzerland. Decision-making had in the past been concentrated at Roche headquarters.

Roche also preserved many Genentech jobs. Parent Roche shut its Palo Alto (Calif.) facility and axed 500 of about 3,000 jobs at its Nutley (N.J.) site as part of a manufacturing shakeup. More cuts may be in store, said Karl-Heinz Koch, an analyst at Helvea in Zurich. Nutley is home to Roche's labs for research and early development of compounds to treat cancer, viruses, and inflammation. Genentech labs are also targeting those same therapies, he said.

Roche is changing how its own labs work after its scientists saw that Genentech's setup made more sense, CEO Schwan said. In the past, Roche maintained separate departments for laboratory research and early-stage drug testing in people. Now it's adopted Genentech's practices of combining them.

Schwan said that Roche's concerns over losing Genentech staffers led to the integration being handled differently than previous acquisitions. "If we look back a year ago, it was of utmost importance to keep the spirit and the culture of Genentech and to keep innovation thriving," he said. "It was really, really important to retain people and to retain scientists." Roche distributed $375 million in payments to prevent defections, and none of the top scientists from Scheller's research and early-development group left, even after the retention payments ended, Schwan said. In fact, staff fluctuation rates at Genentech are lower than they were before the purchase was announced, he said.

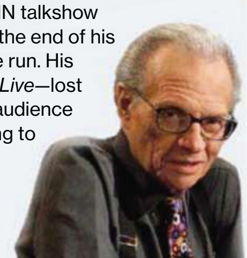
One reason: Roche didn't tamper with Genentech's culture of research and innovation, which encourages employees to pursue their own projects and creates a workplace where jeans predominate, hierarchy is kept to a minimum, and scientists have easy access to top managers, said Mark Sliwkowski, a 19-year veteran there.

"Genentech has always had as an explicit goal being a great place to work," Clark said. "I don't think that was such a conscious goal for Roche, and that may be one place where our culture can rub off a bit." *—Dermot Doherty and Rob Waters, with Eric Burg and Ellen Gibson*

The bottom line *Many analysts worried Genentech would lose talent and its innovative culture after its acquisition by Roche. Yet, so far, it's thriving.*

Quoted

"It's time to hang up my nightly suspenders."
—Larry King, CNN talkshow host, announcing the end of his 25-year primetime run. His show—*Larry King Live*—lost 40 percent of its audience this year, according to Nielsen, part of a broader slump for the cable news network





FROM LEFT: LORENZO BEVILAQUA/CNN VIA BLOOMBERG; THOMAS PETER/REUTERS

Airlines

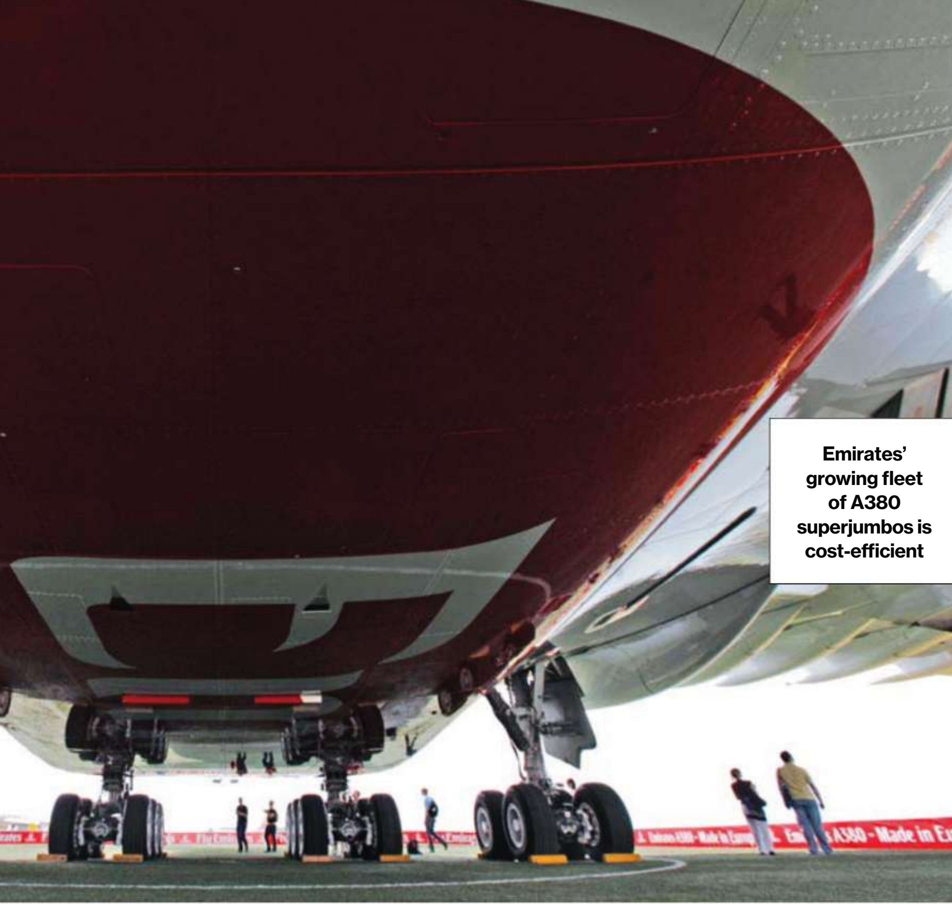
Emirates Wins with Big Planes and Low Costs

▶ The Dubai-based airline has quickly become a top international carrier

▶ "The words 'ticket tax' haven't been translated into the Arabic language"

While the last five years have been grueling for much of the airline industry, Dubai-based **Emirates** has prospered, becoming one of the top three international carriers. Now, the 25-year-old government-owned airline is on the offensive. To bolster its all-widebody fleet, it's adding 90 Airbus A380 superjumbo jets with 45,000 seats and operating costs 12 percent lower than rival **Boeing**'s latest 747. That huge fleet of double-decker widebodies poses a threat to big European carriers that, like Emirates, specialize in flying passengers long distances through giant transfer hubs, says **British Airways** CEO Willie Walsh.

Emirates' latest order for 32 A380s valued at $11 billion, announced in June, will give it 70 more superjumbos than any other airline. "It's a miracle that Emirates already has more intercontinental seats than Air France and British Airways combined," says Wolfgang Mayrhuber, CEO of **Lufthansa**. "It took



Emirates' growing fleet of A380 superjumbos is cost-efficient

us 40 years to get 30 747s in the air in one of the biggest global economies, so one must assume that this is an investment for the world."

Emirates ranked only 24th among international airlines as recently as 2000. Since then it's achieved a sixfold increase in traffic—defined as passengers carried multiplied by the distance flown. The Dubai carrier zoomed ahead last year to join Lufthansa and **Air France-KLM Group** as the biggest operators of international flights. "We always planned to grow, we were just never able to put our finger on how quickly," says Maurice Flanagan, founding CEO at Emirates and currently executive vice-chairman. "Now we're short of capacity all the time."

Key to Emirates' success: flying super-sized planes—one of its A380s carries about 500 passengers—to reduce expenses per head. The savings help it undercut fares of established rivals like Lufthansa, Air France-KLM, and **Singapore Airlines** while still making money. Emirates reported net income of $964 million for the year through Mar. 31.

"I can't understand why other airlines have been slow to pick up on the A380," Flanagan says. "The economics are fantastic. It has given us a huge advantage because the seat-mile costs are much lower than on any other aircraft."

Chris Tarry, an independent airline analyst, says Emirates' business model is largely the result of improved jetliner range and Dubai's location midway between Europe and Asia. "First, there's now the technological capability to join any two places on the globe with just one stop," Tarry says. "Second, Dubai is well placed to capture intercontinental traffic flows from North America to Asia, and Europe to Asia and Australia."

Emirates' moves could slam competitors. "It's challenging a segment of the market that is important for BA," says BA's Walsh. "But there are other European hubs where the reliance on transfers is bigger," such as Lufthansa's in Frankfurt and Air France-KLM's in Paris and Amsterdam, he says.

The Emirates model relies on treaties that permit flights between two nations by an airline from a third via its home country. The model works best on long-haul routes requiring refueling, where Emirates doesn't lose out to competitors by stopping in Dubai.

As the Emirates fleet has grown, so has opposition from European carriers, which say the company benefits either directly from funding by Dubai or indirectly through less-costly access to state-owned airport and air-traffic services.

Dubai airport's passenger total rose 9.2 percent, to 41 million, in 2009. The terminal ranked fourth on international flights in March, behind London Heathrow, Paris-Charles de Gaulle, and Hong Kong International. Flanagan says Emirates has gained no unfair advantage and that any government assistance received since the company's founding is dwarfed by past government payments to formerly state-owned BA and Air France.

Lufthansa says Emirates will be further aided by German Chancellor Angela Merkel's plans to introduce a tax on passengers departing from German airports in an effort to raise 1 billion ($1.22 billion) euros a year for the federal government. By contrast, says Lufthansa's Mayrhuber, "the words 'ticket tax' haven't been translated into the Arabic language yet."

Still, the chances of European countries blocking route applications from lower-cost Gulf carriers like Emirates are slim because of the impact that would have on Airbus, says Richard Aboulafia of consultant Teal Group. (Airbus has received support from European governments in the past.) The planemaker, which has plants in France, Germany, Spain, and the U.K., has 280 orders for its A380 and A350 models from Emirates, **Qatar Airways**, and **Etihad Airways** of Abu Dhabi. "The Middle East is grabbing market share from legacy airlines, and European governments seem willing to make that sacrifice," Aboulafia says.

—Steve Rothwell and Andrea Rothman, with Cornelius Rahn

The bottom line *Emirates all-widebody fleet cuts costs. It's adding 40,000 new seats that will need to be filled to keep capitalizing on those efficiencies.*

Autos

Fiat Tries a Makeover For Chrysler's Flagship

▶ The Italian automaker bets on a redesign to resurrect the Jeep line

▶ "Grand Cherokee is a sign we're moving toward a broader appeal"

Jeep has frustrated a string of corporate owners since its 1941 debut as an all-purpose vehicle for the U.S. Army. From Willys-Overland Motors, developer of the civilian model, through Kaiser Jeep, American Motors, Renault, Chrysler, DaimlerChrysler, and Cerberus Capital Management, each new

Companies&Industries



The 2011 Jeep Grand Cherokee: Aside from the seven-slot grille, there's little in the new model that speaks to its roots as a military vehicle.



Jeep Willys MB



A Touch of Class: To better compete with other premium SUVs, the new model boasts luxury touches in the interior cabin, such as leather seats and real wood trim. Laminated glass on the front doors and windshield cut down on wind noise.



Ups and Downs: For off-roading fun, drivers can raise the suspension to get 10.7 inches of ground clearance by flipping a switch. Stretching the wheelbase by 5.3 in. buys 4 in. of additonal leg room for passengers in the rear.



Elbow Room: The redesigned Cherokee is 1.8 in. longer and 2.6 in. wider than its predecessor. It also has 17 percent more cargo space.



Cabin Comforts: Keyless ignition and satellite radio are standard. Options include a heated steering wheel, and heated front and rear seats. Other extras: a TV and gear that turns the vehicle into a mobile Wi-Fi hotspot.

steward of the brand tried, with varying degrees of success, to win over mainstream drivers without alienating off-road enthusiasts. In the U.S., Jeep's sales peaked at 554,466 in 1999; last year, they sank to 231,710 as Chrysler went through a $12.5 billion government-backed bankruptcy.

Now it's **Fiat**'s turn. The Italian automaker, which took control of Chrysler when it emerged from bankruptcy, is counting on the 2011 Jeep Grand Cherokee to reverse the slump. The new model, which began arriving in showrooms in late June, features plenty of luxury touches—leather seats, interior wood trim, a heated steering wheel. Options include satellite television and technology that turns the vehicle into a Wi-Fi hotspot.

The breakthrough feature is an adjustable suspension system that enables the SUV to achieve 10.7 inches of ground clearance, allowing the kind of off-roading experience many buyers expect from a Jeep. Prices start at $30,995—about $500 cheaper than its predecessor. The priciest version costs $42,995.

The redesigned Jeep is the first major new model Chrysler has introduced since Fiat assumed control and is crucial to the company's turnaround plans. "Jeep is arguably one of the most important brands for the company because of its global appeal, and Grand Cherokee is the Jeep that makes them the most money," says Rebecca Lindland, an analyst at IHS Automotive. "This is a company that is coming out of major surgery, and every setback is a threat to survival."

The Italian automaker has set a target of selling 800,000 Jeeps a year worldwide by 2014, up 61 percent from 2008. "The Grand Cherokee is a sign we're moving toward a broader appeal," says Michael Manley, head of the Jeep brand and Chrysler's international operations.

Jeep's previous owners failed to anticipate the late-1990s shift to car-like SUVs such as **Honda Motor**'s Pilot and **Ford Motor**'s Escape, says Dennis Pietrowski, managing director of market researcher RDA Group. On top of that, quality concerns have dented Jeep's image. It placed 27th out of 33 brands in J.D. Power and Associates' ranking of initial quality released on June 17. Jeep defectors also frequently cite poor fuel economy and a rough ride among their justifications for ditching the brand.

That's one reason the new Grand Cherokee has been engineered with improved suspension and handling. A new V-6 engine will boost mileage by 11 percent. Chrysler wants to make Jeep the "No. 1 SUV brand again," says Manley, and is determined not to let the Grand Cherokee become a "niche" vehicle.

One thing riding in Fiat's favor is the Italian automaker's global reach—Chrysler currently sells 90% of its cars in North America. Starting next year, Jeep will be the only Chrysler brand sold around the world, as Fiat plans to rebadge other Chrysler models as Lancias in Europe. Says Manley of Jeep: "With our partnership with Fiat, we can now focus on Jeep as an international brand." —*Jeff Green*

The bottom line *The redesign of Chrysler's flagship Jeep model will be an important test of Fiat's ability to turn around the ailing American carmaker.*

Consumer Electronics

Sony Seeks Relevance In an Apple-Centric Age

▶ It aims to turn the PlayStation into a media hub to regain buzz

▶ "A television without content is like a refrigerator without food"

Sony once set the standard for inventing products people never knew they wanted—from the Walkman to the CD player to game consoles. That knack for shaping consumer tastes powered the Japanese company's market share and ability to command premium prices for its gear. If that sounds a lot like the recent history of **Apple**, that's a big part of Sony Chief Executive Sir Howard Stringer's current challenge.

So how can Sony set itself apart in an Apple world? Stringer is taking a page from the iPod maker's playbook: He wants to digitally funnel Sony's trove of music, movie, and gaming content directly to its TVs and other devices. Key will be Sony's PlayStation 3 game console and its wireless Blu-ray players, which Stringer is pushing as media hubs



Sony CEO Stringer (in 3D glasses) is betting big on the technology

STRINGER: DANIEL ACKER/BLOOMBERG. OPPOSITE PAGE, CLOCKWISE FROM TOP: DAVID MCNEW/GETTY IMAGES; MATT SLOCUM/AP PHOTO; ROB CARR/AP PHOTO; DANIEL ACKER/BLOOMBERG; CHRIS HONDROS/GETTY IMAGES; JEFF HAYNES/AFP/GETTY IMAGES; CHRIS HONDROS/GETTY IMAGES

A U.S.-South Korea trade revival? page 26 ▶



that (like Apple's iPhone and its Apps store) can link audiences to content without a computer.

Stringer's strategy faces challenges, as shown on June 29 when Hulu, the video website run by **NBC Universal**, **News Corp**.'s Fox, and **Disney**'s ABC, unveiled its much-anticipated subscription service to push TV shows to consumer devices. Hulu Plus will be available exclusively for hardware made by Apple and **Samsung** at its debut. Sony wanted to be part of the initial deal, and will now have to wait until fall to get in on the action. It's a setback because Sony is eager to use content deals to spur sales of its gear. "That's the experience you need to drive Sony into the digital future," Stringer said before the Hulu decision.

Stringer's predecessor, Nobuyuki Idei, tried to marry content and hardware and was thwarted by warring factions within the company. The recession gave Stringer an opportunity to upend the status quo. Besides firing 19,500 people and outsourcing much of Sony's TV manufacturing, he replaced long-serving division chiefs with younger, more collegial managers. "There are still silos at Sony," says Richard Doherty, who runs the market research firm Envisioneering. "But now at least they're sending smoke signals to one another."

Stringer says he chose his team—dubbed the Four Musketeers—because he deemed them less likely than their predecessors to use the "past as a blueprint." The Musketeer to watch is Kaz Hirai, 50, who worked at Sony Music and helped popularize the PlayStation. Hirai now runs the Networked Products & Services Group. Before his ascension, the TV, game, and movie units each had their own way of delivering Web content. Hirai has got them working together, Stringer says, and made it possible for consumers to use one account to access movies, shows, and Webisodes on any Sony device—much as Apple does with iTunes.

Stringer hopes to use the PlayStation Network as a model for the entire company. That four-year-old service has 50 million registered users who can buy or rent video, games, and music over the Web. Stringer aims to sell 350 million networked gadgets and generate $3.4 billion from network services, which include movies and games, by Mar. 31, 2013. No one doubts networked gadgets are the future, and everyone is pursuing them. "People like their stuff to work together," says Jeff Barney, who oversees digital products at **Toshiba**. "That's where Apple has challenged us." Sony also faces **Microsoft**, which has similar hopes for its Xbox 360 game console.

Stringer's competitive advantage may lie in 3D, a technology Sony is spending $100 million to promote, according to U.S. marketing chief Mike Fasulo. Again, Stringer hopes to spur sales of 3D TVs and DVRs with a rush of content—from a *Wheel of Fortune* game to World Cup coverage shot in 3D. "A television without content is like a refrigerator without food or a car without gasoline," Sony Pictures chief Michael Lynton said during a June presentation.

Doherty sees Sony ahead of Panasonic and Samsung in 3D: "Sony is in the catbird seat as far as having the most Blu-ray players out there [and] they have the only game console that can be upgraded to 3D." Still, recession-squeezed consumers may not be ready to spend $3,900 for a Sony 46-inch 3D set. So Stringer may have a hard time hitting his target of $11.3 billion in 3D-related sales by mid-2013, analysts say.

In fiscal 2009 and 2010, Sony lost a combined $1.4 billion. In May, however, the company said it would earn $540 million this year, a sign the cost-cutting has stabilized its financial position. Now Stringer has to prove that the long-promised synergies of his businesses can be realized.

—Cliff Edwards, Ronald Grover, Greg Miles, and Mariko Yasu

The bottom line *Sony is increasingly being eclipsed in consumer electronics by Apple. So it's pushing its content over networked devices to fight back.*

White-Collar Crime

Who Could Gain From a High-Court Ruling

The cases of Enron and Hollinger executives were sent back to lower courts on June 24 when the U.S. Supreme Court narrowed a federal law that prohibits depriving another person of the "right to honest services." The justices ruled that it should apply only when bribery or kickbacks are involved. Now attorneys can argue that convictions should be thrown out, either because juries relied on too-broad interpretations of the provision or because references to it tainted jury deliberations on other charges. Here is how the ruling might affect some prosecutions. —*Caroline Winter*



Conrad Black

Sentence: 6.5 years in 2007

The former Hollinger International chief can now challenge at least part of his conviction and sentence.



Bernard Ebbers

Sentence: 25 years in 2005

The ex-WorldCom CEO's case won't be affected, because the honest services law played no role in his conviction.



Richard Scrushy

Sentence: Almost 7 years in 2007

The ex-HealthSouth CEO's corruption conviction will be reviewed in light of the June 24 ruling.



Jeffrey Skilling

Sentence: 24 years in 2006

The former Enron CEO now may have grounds to seek a reversal of his conviction and sentence.



Dennis Kozlowski

Sentence: Up to 25 years in 2005

The former Tyco International CEO was convicted on New York State fraud charges; his fate is unchanged.



Timothy Rigas

Sentence: 20 years in 2004 (reduced to 17 in 2007)

Convicted on other charges, the ex-CFO of Adelphia won't be affected.

Advertising

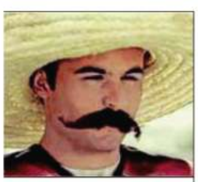
A Hated Rival Turns Mexican Pitchman

▶ Landon Donovan trades on his unpopularity south of the border

▶ The U.S. soccer star taunts fans, saying: "In Mexico, it's easier to win!"

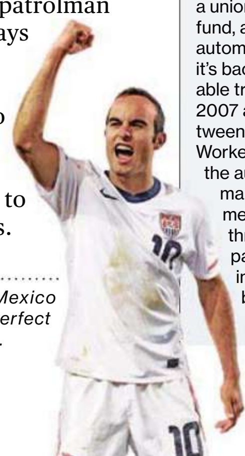
In the U.S., Landon Donovan is the hero whose last-minute goal gave the nation its first World Cup group win in 80 years. In Mexico, he's a renowned villain who plays a bad guy in a series of Mexican TV ads. As the spokesman for a **Grupo Televisa** soccer-betting game called Gana Gol, his job is to get under Mexicans' skin.

In one way or another, Donovan has been doing that ever since he scored his first goal against the Mexican national team in 2000. He was caught on tape in 2004 relieving himself on the field of revered Mexican team Chivas. Last year he caused a stir by insisting that the U.S. could beat Mexico "anywhere else in the world" except Azteca Stadium in Mexico City, where the Americans traditionally struggle.



Donovan, in disguise, is promoting a soccer-betting game in Mexico

In a Gana Gol spot, Donovan sneaks across the border into Mexico, clad in a zarape, a sombrero, and a giant mustache. A guard catches Donovan, and under interrogation, the California native explains in fluent Spanish (Donovan is bilingual) that he's sneaking in because "in Mexico, it's easier to win!" The patrolman growls, and Donovan says he's only talking about the opportunity to win at Gana Gol. Ordered to return to the U.S., he runs off, muttering an expletive Mexicans use to taunt soccer opponents.
—*Crayton Harrison*



The bottom line *The U.S.-Mexico rivalry makes Donovan the perfect bad guy for Mexican marketers.*

In brief

by Cristina Lindblad



Google has redirected Chinese searchers to its Hong Kong site, angering Beijing

Google
The New Threat From Beijing
Google may lose the right to operate in China after Beijing objected to its efforts to skirt censorship controls. In March, the search-engine company began automatically redirecting users on the Chinese mainland to its uncensored site in Hong Kong. Chinese authorities indicated on June 29 that they would not renew Google's license if it continued the practice. Google has proposed a compromise whereby it would point users to the unfiltered Hong Kong site rather than routing them there automatically. That may not be enough to mollify Beijing: On June 30, Google reported that its mainland search engine had been partially blocked.

Ford
An Encouraging Sign In Detroit
Ford Motor will pay about $3.8 billion into a union health-care fund, a sign that the automaker is confident it's back on a profitable track. Under a 2007 agreement between the United Auto Workers and Ford, the automaker must make annual payments into the fund through 2022. As part of an ongoing effort to pare back debt, Ford opted to pre-pay $2.9 billion, on top of the $859 million installment that was due by June 30.



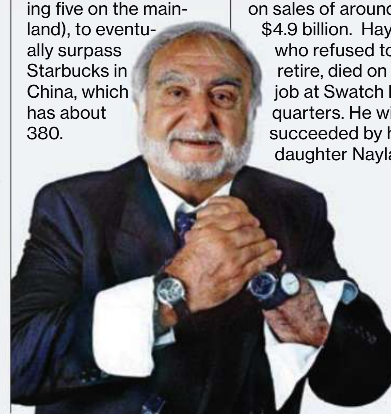
Le Monde
Investors Throw It a Lifeline
Le Monde, France's struggling newspaper of record, has accepted a buyout offer from a trio of investors that includes an Internet billionaire, a banker, and a member of the fashion Establishment. French Prime Minister Nicolas Sarkozy had pressured the managers of the 65-year-old Paris daily to reject the bid. At least one of the investors, Pierre Bergé, the business partner of the late designer Yves Saint Laurent, is allied with members of the leftist opposition. The businessmen have offered to retire nearly $74 million of the paper's debt and kick in more than $61 million in new investment.

Telefónica
Portugal Blocks a Bid In Brazil
The Portuguese government used its veto power to block Telefónica's $8.7 billion bid for Portugal Telecom's stake in Vivo, Brazil's largest mobile carrier. Telefónica, which owns half of Vivo, launched a tender offer that drew participation from 74 percent of Portugal Telecom investors present at a June 30 shareholder's meeting in Lisbon. But Prime Minister José Sócrates invoked the government's "golden share" in the onetime telecom monopoly to block a deal. The Court of Justice of the European Communities in Luxembourg will weigh in on the issue on July 8.

China Resources
Battling to be King of Mainland Coffee
China Resources, the state-backed company that is the largest coffee brewer in China, is paying $42 million for control of Hong Kong's No. 2 chain of cafes, Pacific Coffee Group. China Resources says it plans to grow Pacific Coffee, which has 88 outlets (including five on the mainland), to eventually surpass Starbucks in China, which has about 380.

GlaxoSmithKline
More Setbacks for a Diabetes Drug
A pair of new studies link GlaxoSmithKline's diabetes drug Avandia to heart attacks and other cardiovascular complications. One study found that almost 50,000 elderly Americans either died or suffered strokes or heart failure after taking Avandia instead of a rival medication since 1999. Scientists involved in both studies have called for the drug, which had sales of $1.2 billion last year, to be pulled from the market. A UBS analyst estimates Glaxo's potential liabilities from some 13,000 Avandia lawsuits at $1.1 billion. Glaxo says it will review the data with the FDA at a meeting in July.

Swatch
The Savior of the Swiss Watch Industry Dies
Swatch Group Chairman Nicolas Hayek (below) died of heart failure on June 28 at the age of 82. The Lebanese-born Hayek is credited with reviving the Swiss watch industry in the face of competition from cheaper, Japanese-made watches in the 1980s. As a consultant, he advised the makers of Omega, Longines, and Tissot watches to merge and develop an inexpensive watch, called the Swatch, to market along with their more expensive timepieces. Swatch posted a profit of around $840 million last year on sales of around $4.9 billion. Hayek, who refused to retire, died on the job at Swatch headquarters. He will be succeeded by his daughter Nayla.



CLOCKWISE FROM TOP: REUTERS; FEDERICO GAMBARINI /EPA/LANDOV; APN/AP PHOTO; SIMON BRUTY/SPORTS ILLUSTRATED/GETTY IMAGES


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Next Up for BP: RICO Claims

▶ **Private racketeering suits may foreshadow U.S. prosecution**

▶ **"This is an intentional effort to subvert the law"**

Legal experts agree it's almost a foregone conclusion that the federal investigation of the Gulf of Mexico oil spill will produce criminal charges. After all, mere negligence leading to serious oil pollution constitutes a misdemeanor under the Clean Water Act. Whether BP or any individual will face felony charges–or even prison time–is a more complicated question. One hint of what a broader indictment might look like comes from an unlikely source: private civil-racketeering lawsuits that have been brought on behalf of property and business owners in Alabama, Florida, and Louisiana.

One of the suits, filed on June 12 in federal district court in Pensacola, Fla., by the plaintiffs' firm, **Levin Papantonio Thomas Mitchell Echsner Rafferty & Proctor**, not only accuses BP and Chief Executive Officer Tony Hayward of discrete instances of pollution; it also alleges the company engaged in an illegal "enterprise" to mislead regulators over a period of years.

Included in this alleged pattern of wrongdoing was BP's failure to improve its safety practices in response to past incidents, resulting in criminal fines, the suit says. An explosion in 2005 at BP's Texas City (Tex.) refinery, which killed 15 workers, and an oil leak in 2006 from a BP pipeline in Alaska are among the episodes cited in the suit.

Taken together with the Deepwater Horizon disaster, the Florida suit alleges, these events show that BP engaged in a scheme that violated the civil provisions of the Racketeer Influenced & Corrupt Organizations Act. The RICO law was enacted in 1970 to help prosecutors put Mafiosi behind bars. It has been used more broadly against corporations and high-profile individuals, including junk-bond impresario Michael Milken in 1989. It allows prosecution of people who operate or oversee an illegal enterprise, even if they did not commit the main criminal acts in question. The maximum prison term is 20 years for each count.

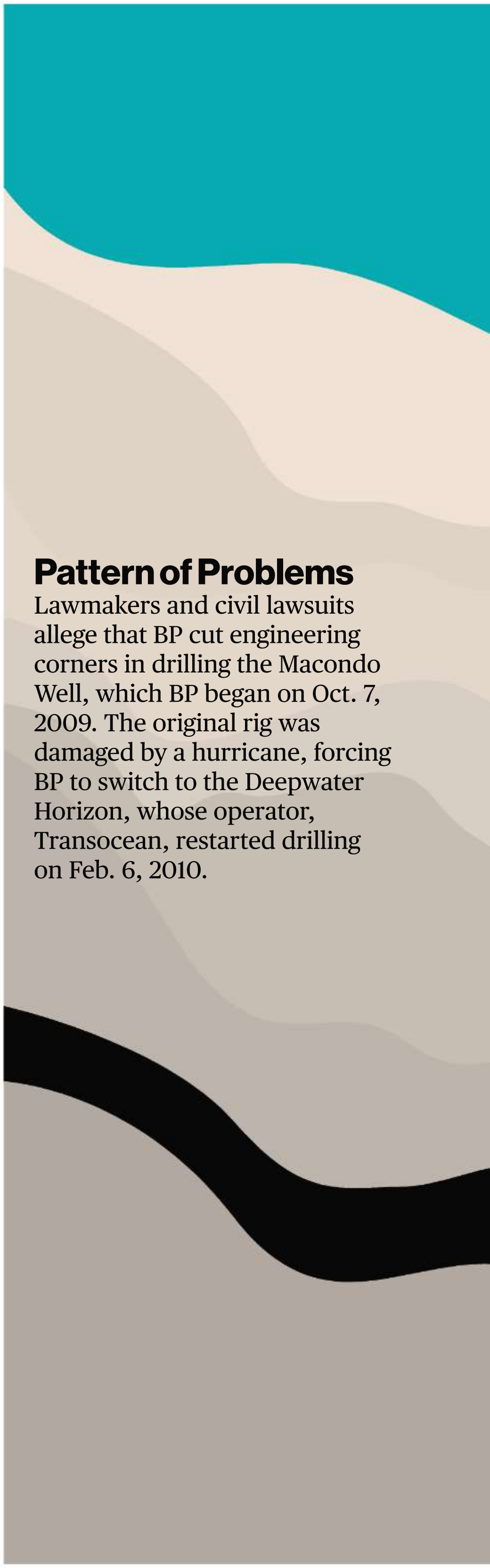
In the hands of a bold prosecutor, the facts and theory that underpin the Levin Papantonio firm's civil suit could add up to something more: a criminal indictment. "I would be amazed if

Tony Hayward
BP Chief Executive

Eric Holder
U.S. Attorney General

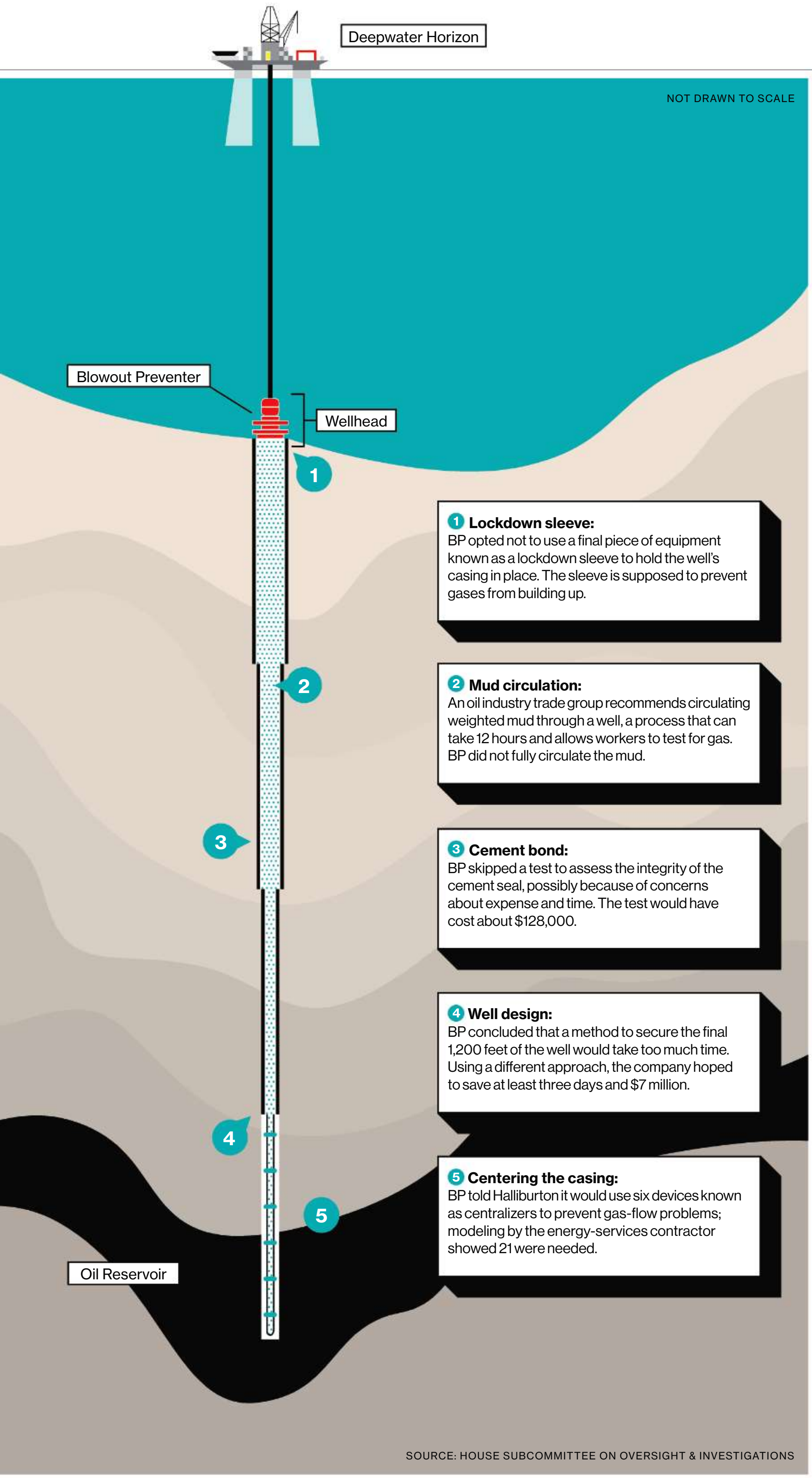
J. Michael Papantonio
Levin Papantonio





Pattern of Problems

Lawmakers and civil lawsuits allege that BP cut engineering corners in drilling the Macondo Well, which BP began on Oct. 7, 2009. The original rig was damaged by a hurricane, forcing BP to switch to the Deepwater Horizon, whose operator, Transocean, restarted drilling on Feb. 6, 2010.



the U.S. government didn't use this as a road map to some sort of criminal case," says attorney J. Michael Papantonio, an outspoken liberal who appears frequently on cable-TV talk shows. "This is not a case of a mistake. This is an intentional effort to subvert the law."

In his suit, Papantonio asserts that filings BP made from 2000 to 2009 with the Interior Dept.'s Minerals Management Service misrepresented the company's preparations for a potential deepwater disaster and dishonestly minimized risks. One BP document, an "Initial Exploration Plan" submitted to MMS in February 2009, claimed that the company had "the capability to respond, to the maximum extent practicable, to a worst-case discharge or a substantial threat of a discharge," the suit states.

Contrary to such written assertions that BP was capable of remedying a major oil spill, the company and its executives have conceded since the Apr. 20 rig explosion that they weren't prepared, the suit claims. CEO Hayward told the *Financial Times* in a June 3 article: "What is undoubtedly true is that we did not have the tools you would want in your tool kit." He added that it was "an entirely fair criticism" to say the company had not been ready for a deepwater oil leak.

The Florida suit argues that BP knew all along that its tool kit was deficient and assured the government otherwise. A separate civil racketeering suit filed in Louisiana on June 21 makes similar allegations. The one in Alabama is narrower and targets BP's conduct in responding to damage claims since the spill.

The RICO approach could allow BP's antagonists–in either a civil or criminal context–to argue that cost-cutting steps in 2010 contributed to the blowout that killed 11 workers and led to the environmental crisis. Two days after Papantonio filed his suit, Representatives Henry A. Waxman (D-Calif.) and Bart Stupak (D-Mich.) of the House Energy & Commerce Committee outlined in a 14-page letter to BP five decisions the company made that allegedly sacrificed safety for cost savings.

One example involved a "cement bond log," in which acoustics are used to determine whether the

cement around the well had formed a tight bond or whether the cement job was imperfect, in which case gas could leak out. BP had hired the energy services contractor **Schlumberger** to conduct the cement bond test but sent the Schlumberger crew back to shore the morning of the Apr. 20 explosion. The Waxman-Stupak letter suggests that BP canceled the test to save itself $128,000 and an additional 9 to 12 hours for a job that was already way over budget and behind schedule. Gordon Aaker Jr., an engineering consultant hired to advise the House committee, called the failure to test the cement bond "horribly negligent."

BP spokesman Scott Dean declined to comment, saying the company isn't talking about pending litigation.

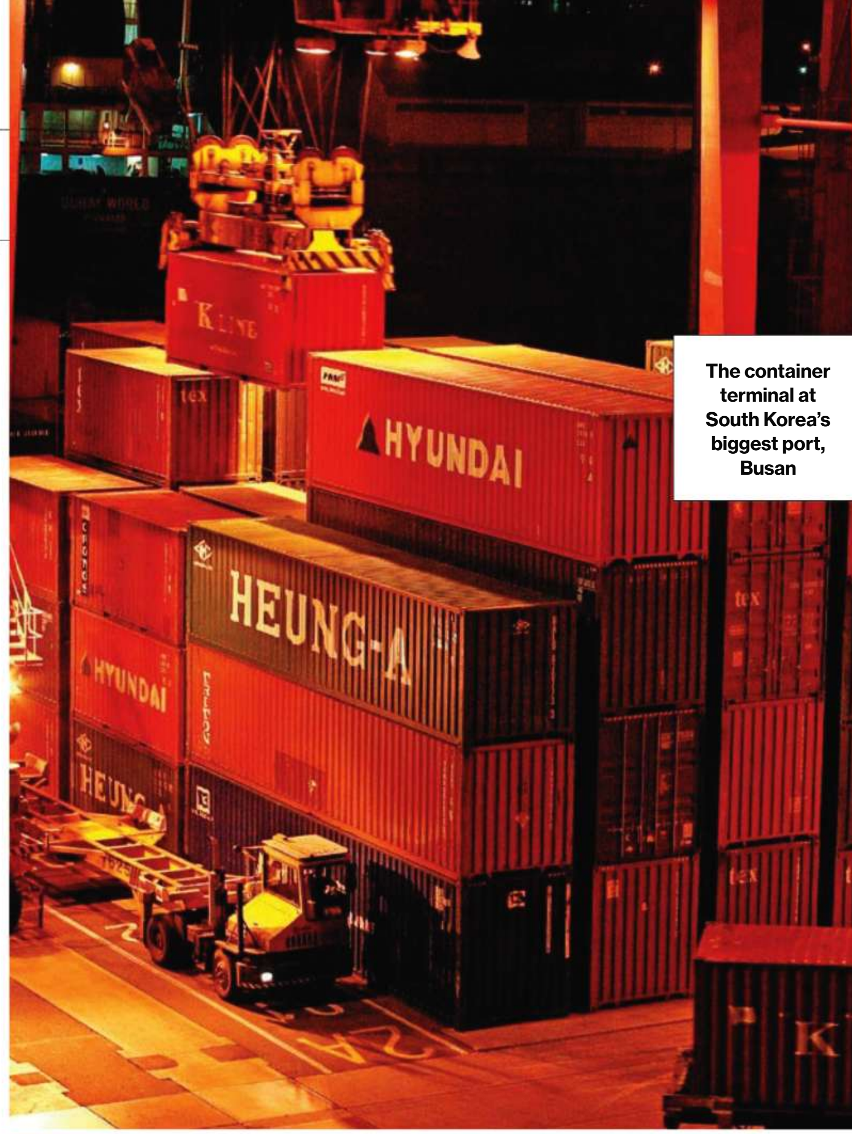
Andrew Ames, a Justice Dept. spokesman, also declined to comment beyond referring to Attorney General Eric Holder's June 1 statement, in which he said prosecutors would look into potential civil and criminal infractions under a range of environmental and other federal statutes.

U.S. courts have narrowed the potential applicability of RICO in recent years. Winning a criminal racketeering verdict requires meeting a stiffer standard of proof than the one that applies in a civil case. Still, the filing of a criminal racketeering indictment against BP or its employees could have catastrophic effects for the company. Such charges likely would result in further reductions to BP's credit rating and increased chances of a Chapter 11 bankruptcy filing. Financial instability could endanger the $20 billion escrow fund BP has agreed to create to pay claims related to the spill.

For that reason alone, the Obama Administration would think long and hard before going the RICO route. On June 16, President Barack Obama said "BP is a strong and viable company, and it is in all our interests that it remains so."

On the other hand, if oil continues to spew all summer, and the slick spreads around the Florida Keys and up the East Coast, demands for punitive government action could grow. —*Paul M. Barrett and Justin Blum*

***The bottom line** A civil racketeering suit in Florida could provide a road map for prosecutors looking to bring felony charges against BP.*



The container terminal at South Korea's biggest port, Busan

Trade

Obama's Trade Agenda Collides with Detroit

- He hopes to revive a stalled trade pact with South Korea
- "We are open to a good trade agreement, but this one flunked"

When heads of state gather for fancy dinners and friendly chatter, leaders sometime cut through their own ponderous bureaucracies and actually get something done. President Barack Obama and South Korean President Lee Myung Bak did just that on June 26 when they announced at the Group of 20 summit in Toronto that they intended to revive a trade agreement inked back in 2007 but never approved by either country's legislature.

Both sides aim to rework the deal by November, when the G-20 next meets in Seoul. With nearly $68 billion in two-way trade, it would be the largest U.S. free-trade pact since Nafta in 1994 and could help Obama make good on a March pledge to double American exports in five years.

Obama hasn't sent the existing deal to Congress because of labor opposition. The U.S. economy's massive job losses—15 million people were jobless as of May—doesn't help matters. An even more intractable problem in the way of a new agreement involves trucks. **Ford Motor** and the United Auto Workers want Washington to keep a 25 percent tariff on pickup truck imports into the U.S. (Ford's F-series is America's best-selling vehicle.) The deal with the South Koreans would require the U.S. to phase out that tariff over the next decade.

Right now, **Hyundai Motor** and **Kia Motors**, the two largest Korean automakers, don't make trucks that could compete with the American brands. However, in a September filing to the U.S. Trade Representative, the UAW said: "It would be relatively easy for Korean manufacturers to ramp up production for export to the U.S." Adds Barbara

PREVIOUS SPREAD, FROM LEFT: SEAN GARDNER/GETTY IMAGES; LUIS M. ALVAREZ/AP PHOTO; BRUCE GRANER/PNJ/POLARIS. THIS SPREAD, CLOCKWISE FROM LEFT: JEON HEON-KYUN/EPA/CORBIS; TERRY ASHE/GETTY IMAGES; BETTMANN/CORBIS

Somson, the UAW's top official in Washington: "A lot of damage could be done to our jobs in pickup plants."

Ford makes a different case: By agreeing to cut tariffs, the U.S. is trading away its best bargaining chip to pry open the Korean market to American-branded vehicles, something the U.S. has tried and failed to do since the 1990s. This deal "represents the last, best chance to open the Korean market," Ford said in a statement. "There certainly is a problem in Korea," says Daniel J. Ikenson, associate director at the Center for Trade Policy Studies. Still, he believes the Big Three are "more concerned with market competition in the U.S. than in gaining Korean market share."

South Korea's passenger carmakers have made huge inroads in the U.S., which imported $8.4 billion worth of autos and auto parts from Korea in 2009. That could increase by as much as $1.7 billion a year as a result of the free-trade deal, the U.S. International Trade Commission estimates. By contrast the U.S. sent only 6,140 autos to Korea last year, a total Ford blames on a variety of taxes, customs, and regulatory standards that discriminate against foreign competition. "Korea is the classic example of bad trade policy: keeping everyone else out while going on a worldwide export binge," says Stephen J. Collins, president of the American Automotive Policy Council, which represents Ford, **General Motors**, and **Chrysler**. "We are open to looking at a good trade agreement, but this one flunked." GM, which has a South Korean unit, GM Daewoo Auto & Technology, is sitting out the debate, he says. GM makes and sells cars in the Korean market and uses the Daewoo unit to sell to China as well.

One skeptic Obama will have to bring around is House Ways & Means Chairman Sander Levin (D-Mich.), whose suburban Detroit district is home to thousands of autoworkers. Levin offered a proposal in 2007 to make sure as many U.S. cars enter Korea duty-free as Korean cars enter the U.S. duty-free. The 25 percent truck tariff? It would stay in place.

—*Mark Drajem, with Keith Naughton*

The bottom line *The big hurdle to a U.S.-South Korea trade deal may be Ford Motor, which wants to protect its pickup truck market.*

Obituary

Robert C. Byrd



1917-2010

Historian and fiddle player, the West Virginia Democrat was the longest-serving U.S. senator

Three decades ago, Saturday mornings were taken up with Robert C. Byrd's news conferences. They were a bit bizarre, sprinkled with reporters from publications you'd never heard of–one regular was from a Turkish news agency–and the socially awkward Senate Majority Leader would wander into strange asides. Some of us supposedly more urbane mainstream reporters were dismissive: What self-respecting politician held Saturday sessions? It gradually dawned on us that he often was setting the agenda for the Sunday television interview shows and the week ahead, framing issues more effectively than the White House.

It was easy to underestimate Robert Carlyle Byrd, who died on June 28 at age 92. He was fodder for late-night comedians and the blogosphere–pompous, the king of pork, a fiddler with no social life outside the Senate. In a business that places a premium on collegiality and conviviality, Byrd had no talent for either. Few senators considered him a friend; most knew he had their back. What Byrd, elected to the House in 1952 and to the Senate six years later, lacked in sophistication and polish he made up for in shrewdness and persistence.

He was a simple man but not without contradictions. Too poor to attend college, he spent his first 10 years in Congress at night law school and was handed his degree from American University in 1963 by the commencement speaker: President John F. Kennedy. He joined the Ku Klux Klan as a young man and became a hero to progressives in his final years.

He leaves a void that, in an age that caters to the passions of the moment and the 24-7 news cycle, isn't likely to be filled. Byrd was the "ultimate institutionalist," says Andrew Taylor, a scholar at North Carolina State University. "He had an encyclopedic knowledge of the Senate, which is run more by tradition and convention than the heavily rule-bound House. He was the greatest advocate for the institution on the balance of power, where the executive has had the upper hand for most of the last 80 years."

No lawmaker delivered more bacon for his home state–bridges, dams, highways, many bearing the name Robert C. Byrd; he believed the federal government had a responsibility to take care of a poor state like West Virginia. He also was the most passionate defender of the Senate's prerogatives. This transcended partisanship. He fought Bill Clinton's line-item veto with the same vehemence that he opposed George W. Bush's decision to wage war in Iraq. (He called that antiwar vote the best of the 19,000 he cast.)

In 1971 he upset the incumbent Democratic whip, Edward M. Kennedy. That bitter relationship transformed into a close friendship. Kennedy sent Byrd roses–one for each of his years–on every birthday. When Kennedy died last year, the family escorted his body past the Senate. There was a delay, but as the entourage passed, sitting on the front steps of the Senate in his wheelchair, waiting for three hours in 90-degree temperatures, was 91-year-old Robert C. Byrd. Ⓑ

—*Albert R. Hunt*



Early Life ▶ Grew up poor in hollows of West Virginia

Biggest Mistake ▶ Joining the Ku Klux Klan as a young man

Proudest Moment ▶ Voting against the Iraq war in 2002

Pent-up demand for Big Tech page 33 ▶



Local Government

Princeton and Princeton Face Off over Taxes

▶ Town-gown conflicts grow as local tax revenues shrink

▶ "A hedge fund ... promoting an educational arm on the side?"

Princeton University, the fourth-richest college in the U.S., paid more than $10 million last year to its prosperous New Jersey community. Municipal officials and residents say the college, with a $12.6 billion endowment, could do a lot more. The university owns 43 percent of the borough's land by value and 13 percent of adjoining Princeton Township's and would pay at least $28 million more in taxes if none of its properties were exempt, says Princeton Borough Councilman Kevin Wilkes. "The town budget is strapped," says borough resident Peter R. Kann, former chairman and chief executive officer of **Dow Jones** and the co-chair of Princeton Future, a civic organization. The university "give[s] the appearance of being wonderful donors to the town, but compared with what they would be giving the town if they were paying property taxes, it's really trifling."

It's the latest round in the town-gown face-off, as municipalities from Pittsburgh to Boston turn to local universities, whose land holdings are mostly tax-exempt, to close budget gaps. Those institutions say they are pressed for cash after record endowment declines. Princeton's endowment was $16.3 billion on June 30, 2008; a year later it had fallen by $3.74 billion after its investments lost 24 percent. To the locals, even the post-decline endowment is a handsome sum. "Is the university some type of old-fashioned institution full of scholarly gentlemen with modest salaries and a devotion to education?" asks Wilkes, a 1983 Princeton graduate. "Or is it a hedge fund with $16 billion, promoting an educational arm on the side?"

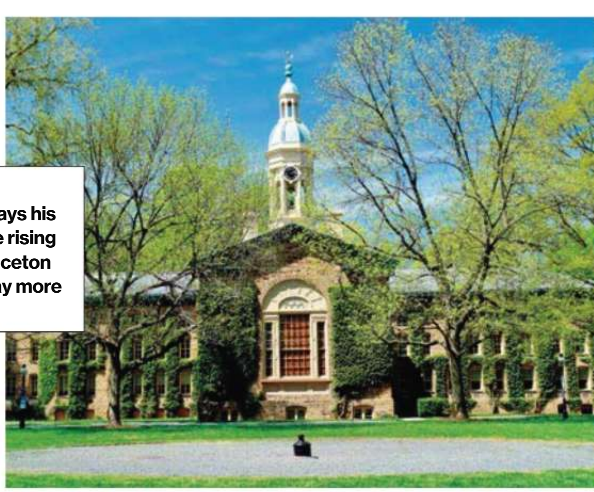
Princeton Borough, nestled within the 17-square-mile Princeton Township, has cut its budget by dismissing two police officers and leaving two positions unfilled. Garbage pickups have been cut back to one a week from two. Princeton Township reduced unionized public works employees to a 35-hour week from June through August. The school board, which oversees schools in both the borough and the township, whacked more than $3 million from its 2010-2011 budget and cut 24 teaching positions.

Property taxes will rise next year for some in Princeton. Leighton Newlin, 58, says he expects to pay an additional $2,000 to $3,000 in taxes on his home in the historically African-American Witherspoon neighborhood of the township. "It would be a hardship on me," he says. "The university has done some things for the community, but it needs to pay its fair share of taxes." Adds Sue Nemeth, a Princeton Township committee member: "The intangible benefits the university offers are lovely, but we can't pave the streets with them."

The university is already the largest taxpayer in Princeton Borough and Princeton Township, says Robert K. Durkee, the university's vice-president and secretary. It paid $8.2 million last year in property taxes and $1.6 million in sewer fees. It also voluntarily paid $1.2 million to the borough in lieu of other taxes. The university employs about 5,300 people and helps generate more than $1 billion in annual economic activity, says a 2008 report by Appleseed, a New York-based consulting firm. For fiscal year 2010 and 2011, Princeton has slashed a total of $170 million from its operating budget, delayed some renovations and new construction, and eliminated 43 positions. "This is not a good time to be asking the university to increase contributions," Durkee says.

Nemeth says other wealthy Ivies have been more generous. **Harvard University**, which has the largest university endowment in the U.S., made $4.14 million in voluntary payments in lieu of taxes in 2009 to Cambridge and Boston. **Yale University**, which has the second-largest college endowment in the U.S., increased payments in lieu of taxes to New Haven to more than $7.5 million in 2009 from $5 million. Tim McNulty, owner of **Green Design**, which sells eco-friendly products on Witherspoon Street a block from the Princeton campus, says it may be time for the university to do more. "If Harvard and Yale's contributions are higher, why not bring Princeton into line?" —*Moira Herbst*

The bottom line *As local governments raise property taxes to run basic services, they want endowed universities to contribute more.*





Newlin says his taxes are rising and Princeton should pay more

CLOCKWISE FROM TOP LEFT: JEFF CHIU/AP PHOTO; ILLUSTRATION BY ANDRE CARRILHO; KAREN BLEIER/AFP/GETTY IMAGES; PHOTOGRAPH BY NOAH SHELDON FOR BLOOMBERG BUSINESSWEEK; ANDRE JENNY/AURORA

Fiscal Policy

Spending Big to Stop Big Spending

▶ A billionaire's anti-deficit crusade rankles some Democrats

▶ "Everywhere you look, he's trying to buy the debate"



Wall Street financier Pete Peterson got a decent return on his investment late June when Senate Republicans ended the Democrats' third attempt to push though an extension of unemployment benefits and President Barack Obama failed to persuade his European counterparts at the Group of 20 confab in Toronto to maintain economic stimulus programs. "I haven't seen anything like this kind of concern in the 30 years I've been talking and writing about this," says the 84-year-old fiscal hawk.

Peterson has committed $1 billion of the fortune he made as co-founder of private equity firm **Blackstone Group** to his personal crusade: raising the alarm about the $13 trillion national debt. He is paying the bills at a foundation that bears his name, supports a network of like-minded advocacy groups, backs The Fiscal Times, an online newspaper, formed a commission of experts, and organizes conferences with marquee guests such as former President Bill Clinton. The crusade appears to be in sync with the concerns of most voters, with a June 4 Gallup poll showing that the federal debt and terrorism were tied for first place (at 40 percent each) as the biggest threats to Americans' future well-being.

His influence is provocative even among those who agree the national debt is a long-term worry. "Everywhere you look, he's trying to buy the debate," says Roger Hickey, co-director of the liberal advocacy group Campaign for America's Future. He calls Peterson-backed organizations, such as the Concord Coalition, nothing more than "front groups" used to help "stampede" lawmakers into cutting Social Security and Medicare.

Some congressional Democrats criticize what they see as Peterson's single-minded emphasis. House Ways & Means Chairman Sander Levin (D-Mich.) says acting to narrow the deficit must be balanced against the need to "make sure we don't slip into another recession."

To his supporters, though, Peterson is the patron saint of fiscal responsibility. "He has devoted more personal wealth to reducing the deficit than anybody in the history of the world," says Representative Jim Cooper (D-Tenn.), a fiscal conservative who voted against the jobless benefits measure.

Peterson's interest in fiscal rectitude has deep roots: The onetime Commerce Secretary for President Richard Nixon has devoted four books and countless op-eds and speeches to the subject. "I've been boring people with it for decades," he said in a speech. Two years ago he kicked the campaign into high gear, vowing to devote a substantial portion of his $1.8 billion payout from Blackstone's 2007 initial public offering to the cause. As the son of Greek immigrants, he says his goal is to ensure that future generations aren't deprived of similar opportunities by a national debt his group estimates at $61.9 trillion, or $200,000 per American, including the cost of fully funding Social Security.

He has been careful to emphasize that he understands the "urgent need to create jobs." At the same time, he says, tough choices lie ahead, including tax increases and cuts in spending that could target entitlement programs. He supports a "well-targeted stimulus" so long as "it is accompanied by meaningful action on the longer-term structural debts and deficits." Peterson had disbursed $300 million of the $1 billion pledge by Mar. 31 of last year, according to tax records. His foundation says its next filing will show that those numbers have increased in the current fiscal year. One of the groups that receives funding from Peterson, AmericaSpeaks, on June 26 organized public meetings on the deficit in 19 venues across the U.S.—a gathering that drew 3,500 participants, according to its website. Ⓑ

—Max Berley and Brian Faler

The bottom line *By pledging to spend $1 billion on an anti-deficit crusade, Pete Peterson is winning converts—and making some enemies—for his cause.*

Quoted

"It wouldn't be appropriate for me to talk about what I might think about past cases ... because those cases themselves might again come before the court."
—Elena Kagan, who once wrote that Supreme Court confirmations had taken on "an air of vacuity and farce" because nominees refused to discuss cases, at her own June 29 hearing.



James Warren

Did Stimulus Work? That Depends. Do You Own a Business?



The stimulus spurred a political debate. But for many business owners, the money made the difference between struggle and survival

Rich DeNormandie is the fifth generation of his family to run a South Side Chicago commercial laundry—and the first to take a government handout. Since April he's used federal stimulus funds to hire six workers at $10 an hour each, even though business from key restaurant and hotel clients is down. He doesn't follow politics closely and didn't vote in the 2008 Presidential election. When money was offered via the state's "Put Illinois to Work" program, he felt hiring the six unemployed women was the right thing to do. "I got some new faces in here and introduced them to the business," says DeNormandie amid the drone of industrial washer-dryers and folding machines. "If the economy comes back, two or three may stay for good."

Expectations for the American Recovery & Reinvestment Act of 2009—the stimulus to you and me—were always a bit unfair. Like the junk shot of golf balls and scraps BP fired into its billowing well, the stimulus was an attempt to fend off economic crisis at a desperate moment with an agglomeration of federal funds. Look over the beneficiaries—individual tax cuts ($116 billion), digital TV transition coupons ($750 million), the National Cemetery Administration ($50 million)—and it's clear the stimulus was an act of ingenuity, not cohesiveness.

Its efficacy has never stopped being debated by Democrats (pro) and Republicans (con) since its February 2009 passage, which shouldn't obscure the fact that, at ground level, employers of all parties say they needed the help. Mike Cullinan runs **R.A. Cullinan & Son**, a Peoria (Ill.) highway construction company that, by the government's fraction-filled reckoning, created 148.33 jobs via 35 projects benefiting from $51 million in stimulus funds. A Republican with an inherent suspicion of big government, he concedes the money "was a fastball for our business."

Cullinan & Son purchased new pavers, rollers, and milling machines. There were hassles with the reporting requirements—"and helping [the federal government] quantify jobs, which wasn't our expertise." But the speedy arrival of dollars (according to Cullinan's CFO, it took as little as 30 days in some cases between filling out paperwork and receiving a check) more than made up for the administrative frustrations. "I can't imagine a clearer place for a government role than transportation and rail, meeting the needs of the traveling public," Cullinan says. "Whatever government can do in these areas, efficiently, I'm for."

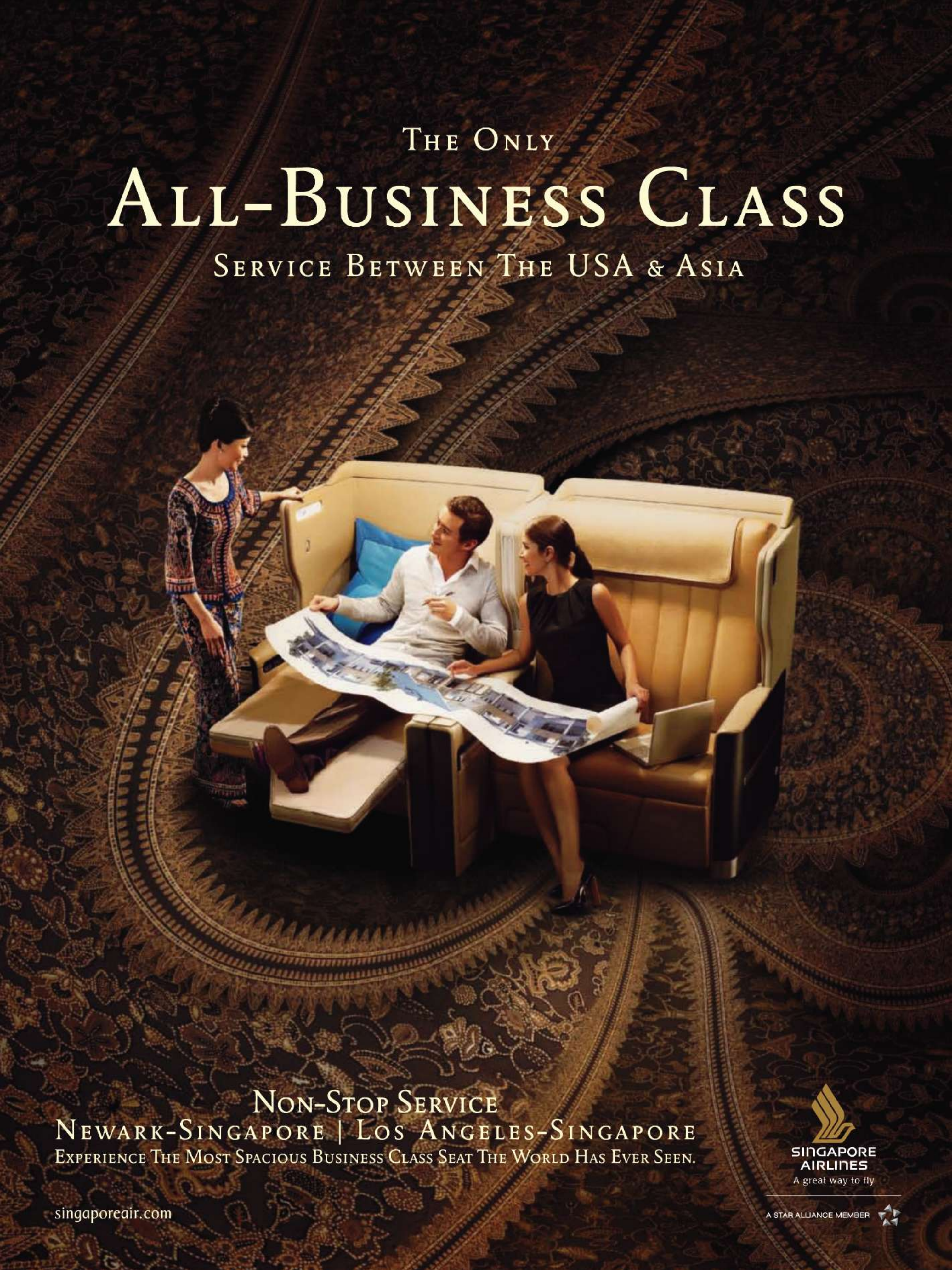
"After the stimulus money runs out, will our customers have enough money to buy these products?"

S&C Electric in Chicago is a manufacturer of "green" products that improve energy transmission. "The fact that government realizes we need to find another source of energy as opposed to oil, and will provide incentives for companies to make this stuff more environmentally friendly, is fantastic," says Michael Moses, the financial services director. With part of the employee-owned company's take of $6 million in Energy Dept. grants and tax credits, S&C financed a gleaming, $40 million, 43,000-square-foot facility on a 47-acre industrial campus.

With the rest, S&C hired 25 full-time employees. The company cites $85 million in orders since January as evidence that spending begets growth. A self-described social Democrat and fiscal Republican who voted for President Barack Obama, Moses raves about the speedy start-to-finish smoothness of his applications to the Energy Dept. and IRS. (In all, the process took three months.) "Our only concern is sustainability," he says, alluding to the economy, not the environment. "After the stimulus money runs out, will our customers have enough money to buy these products?"

"As a small business, this really helped when lending just wasn't available," says John Dernis, co-owner of a Chicago grocery chain, **Michael's Fresh Market**. He's expanding and will hire 50 workers, including some for a new store in Obama's Hyde Park neighborhood. One bit of confusion led to a missed pay period—the government wants payroll sheets to be faxed weekly, not every other week—but his business survived.

And survival, at least for the past 18 months, has been the primary goal for businesses of all sizes and business-owners of all political beliefs. Now that the stimulus is winding down, they have something else in common: hope that they can make it on their own. **B**


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Technology

Spending Is Back, And It May Even Last

▶ **Oracle, Microsoft, Dell, and others report sales gains as corporate customers finally upgrade**

▶ **"A lot of the growth now is being fueled by what's happening in Asia"**

After a somber 2009, the titans of technology are roaring back to life. **Microsoft**, **Dell**, **Oracle**, **Adobe Systems**, and other major companies have all reported strong earnings or given robust sales guidance in recent weeks, buoying prospects for an industry that struggled through the recession. "The business trends are positive," **SAP** Co-Chief Executive Officer Bill McDermott told Bloomberg News on June 23. "Our crystal ball looks good."

Technology is a cyclical business: Hardware and software upgrades are one of the first places companies cut costs. That means tech spending can snap back strongly when the economy improves. After falling by 4.2 percent in 2009, global tech spending is set to rise by 3.8 percent, to $1.5 trillion, this year, according to market researcher IDC.

Microsoft is a clear winner. The company has sold 150 million copies of Windows 7 since its debut in October, making it the fastest-selling operating system in the company's history. That success is the result of a surge in worldwide personal computer shipments—which are on track to rise 22 percent this year, says research firm Gartner—and the fact that many buyers bypassed Windows Vista. Adobe, another software giant, has also had success with its recently introduced Creative Suite 5 software for graphic designers.

The bulk of the industry's growth this year will come not from software but from equipment sales, as companies that had put off purchases invest in the latest servers, computers, networking gear, and storage systems. Hardware sales are expected to see a 6.4 percent gain, according to IDC, while spending on software and technology services will grow by just 3 percent and 1.5 percent, respectively.

A big beneficiary of the hunger for hardware: Dell, the world's third-largest PC maker. It said on June 23 it expects revenue to rise as much as 19 percent—that would bring it to $62.9 billion—compared with a 13.4 percent drop in 2009. Things are looking brighter for Oracle, too, which credits, in part, its $7.3 billion acquisition of server manufacturer Sun Microsystems for a strong fourth quarter ended May 31.



Dell shipment in New York: The company says revenue could rise 19 percent this year

MARK LENNIHAN/AP PHOTO

According to a spring survey by KPMG, tech executives also are excited by newer, high-growth areas such as mobile computing, software delivered over the Web, and applications that can smartly analyze reams of data. **Cisco Systems** on June 29 introduced a tablet computer for business called Cius that's capable of video conferencing. SAP's $5.8 billion acquisition of **Sybase**, expected to close in July, will let it deliver back-office and sales applications more readily on smartphones and tablets. Analysts expect SAP's sales to rise 7 percent, to €11.4 billion ($14 billion), this year after declining 8 percent last year. **IBM** says that in the last four years it has spent more than $11 billion on 19 acquisitions in data analysis as customers look to glean insights from ever larger amounts of data.

It's not all good news for tech companies. Corporate belts in Europe remain tighter because of concerns over sovereign debt. And the euro's 19 percent-plus fall against the U.S. dollar since Dec. 3 is weighing on some U.S. tech companies, as profits earned in Europe translate into fewer dollars. "Everybody's got to raise prices in Europe," Dell CFO Brian Gladden said during a reception at the company's analyst meeting in Austin, Tex., last week.

Tech giants might be able to make up for European weakness with sales in emerging markets such as China, India, Brazil, and Russia, which are expected to account for 11 percent of global technology spending this year, up from 8 percent in 2009, according to IDC. Dell is on track to book nearly $5 billion in sales in China in 2010, making it the company's second-biggest market after the U.S., says Stephen J. Felice, Dell's president for consumer and small and medium business. Sixty percent of tech executives surveyed by KPMG said they expect China to contribute more than any other country to their bottom lines over the next year. Says KPMG's global tech sector leader, Gary Matuszak: "A lot of the growth now is being fueled by what's happening in Asia." —*Aaron Ricadela*

The bottom line *If Asia keeps growing and corporate customers stay enthusiastic about mobile products, Big Tech's turnaround may have legs.*

Technology

Internet

China Plays Rough With Online Gamers

▶ Game companies face new rules as growth slows

▶ Tighter regulation "will be a challenge for operators"



Shenzhen Internet café: Gamers have skirted earlier restrictions

China has 400 million Internet users, a quarter of them avid gamers, accordingn to the China Internet Network Information Center. Despite that enormous market, a government campaign against online gaming is giving investors pause. Shares of **Tencent**, the Chinese market leader in Web-based games, has dropped 23 percent this year. **Perfect World**, another major operator, is off 47 percent, and **Shanda Games** is down 42 percent.

With more Internet users in China than any other country, the Chinese game market seems ripe for growth. Two-thirds of Chinese have never been online and nearly half of China's Web surfers are under 25. "When I've had enough of one game I go on to the next," says Jiang Yuzhuo, a 21-year-old hairstylist who spends as many as four hours a day playing games in Internet cafés.

The Chinese government thinks that's excessive. The Ministry of Culture on June 22 announced regulations setting guidelines for the look and feel of games and requiring that social gamers register under their real names. The ministry also set limits on sales to minors of items using virtual currency, or points earned playing online. The news sent Tencent's Hong Kong-listed shares down 5 percent.

"The new rules will be a challenge for operators," says Galant Ng, an analyst with Tai Fook Securities in Hong Kong. Tencent says the new rules will be good for the industry. Perfect World and Shanda didn't respond to requests for comment.

Gaming companies have other worries as well. While they see plenty of potential growth in poorer regions, it's getting harder to find players who aren't already online in Beijing, Shanghai, and other big cities. Parents are fretting about what they consider to be growing addiction to online games among young people. Though the industry's revenues are likely to grow 22 percent this year, to $4.5 billion, that's far below last year's 40 percent.

All that means the search for new hit games is urgent. This year, Chinese companies will launch 400 new titles, vs. 250 in 2009, says Samsung Securities analyst Paul Wuh. It's hard to stand out in the market because many operators have been churning out similarly themed medieval fantasies with titles such as Battle of Immortals and Dragon Power. "You end up with the same games in the same mythical worlds," Wuh says.

The new rules might inconvenience some players, but China's young gamers managed to evade earlier attempts at control, including a 2005 rule designed to cap how much time minors can play without taking a break (they signed on using older friends' IDs). Tencent and other companies are developing 3D games, which could help woo new players. The companies may also try to diversify into new businesses. Tencent began as an instant-messaging service before transforming into a top portal and game operator. With **Google** facing trouble in China, Tencent is stepping up its search business. "I am inclined to take them seriously in search," says Dave Carini, managing director of Maverick China Research in Beijing, "because they have successfully changed their focus so many times." —*Bruce Einhorn and Mark Lee*

The bottom line *Investors are wary of Chinese gaming stocks as Beijing tightens the reins on Internet games and the industry's growth slows.*

Quoted

"The only reason we won was because of the gross incompetence of MySpace."
—Sean Parker, former president of Facebook

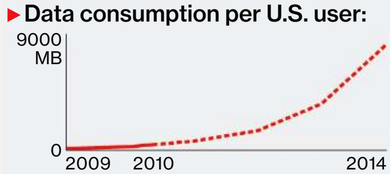


Telecommunications

Wireless Data: The End Of All-You-Can-Eat?

▶ AT&T's switch from unlimited plans may set the tone for U.S. carriers

▶ Data consumption per U.S. user:



DATA: CHETAN SHARMA CONSULTING

When **AT&T** announced on June 2 that it would stop offering an unlimited wireless data plan, it said 98 percent of its customers would save money with the change. About two weeks later, **Verizon Wireless** Chief Financial Officer John Kil-



FROM LEFT: RAMIN TALAIE/CORBIS; IMAGINECHINA/AP PHOTO

lian said the largest U.S. carrier may soon follow suit and switch from all-you-can-eat data programs to tiered pricing.

The savings for half those AT&T customers, however, may disappear by 2013, says independent wireless analyst Chetan Sharma. Here's why: Under the new plan, 2 gigabytes of data will cost $25 a month; each additional GB will cost $10. (The unlimited plan, still available to customers who signed contracts prior to the switch, costs $29.99.) Sharma, who has consulted for Motorola and Qualcomm, predicts the average customer will consume 4 GB of data a month within three years, up from 150 megabytes in 2009 and an estimated 320 MB by yearend, noting that 4G networks, fully in place by mid-2012, will accelerate consumption.

Increasingly versatile and powerful devices such as **Apple**'s iPhone and iPad and **HTC**'s EVO are encouraging users to suck up more data. Verizon will begin selling the iPhone in January, as reported exclusively by Bloomberg News. AT&T, the No. 2 carrier in the U.S., says listening to 2.5 hours of streamed music a day adds up to 2.2 GB of data per month. Streaming a feature-length film to a mobile device eats up about 200 MB. "The downloading of video is really driving data usage," says Greg MacDonald, an analyst at National Bank Financial.

AT&T's data-cap plan remains the exception in the U.S., but the billing method is commonplace in Europe. The move comes as landline revenues are shrinking and data is providing a fast-expanding portion of AT&T's bottom line. Wireless data revenue rose 30 percent for the company in the first quarter, to $4.1 billion, while landline voice revenue fell 12 percent, to $7.5 billion.

Sprint Nextel, the third-largest U.S. wireless carrier, says it has no immediate plans to change its pricing. "It's inevitable that most of the U.S. carriers will switch to tiered pricing as the usage continues to go up," says MacDonald. —*Greg Bensinger*

The bottom line *As mobile data use per customer accelerates, other U.S. wireless providers are likely to follow AT&T and change their pricing policies.*

Venture Capital

Tesla Raises Hopes For Cleantech IPOs

▶ Its stock's 41 percent jump on Day One may herald a shift in sentiment

▶ "You'll see a rush of bankers and companies" pushing green IPOs

With all eyes in the cleantech world focused on **Tesla Motors**' first day of trading on June 29, venture capitalists and industry executives released a collective cheer when the stock of the electric vehicle maker surged 41 percent. Even sweeter, the investor support came on a day when the Standard & Poor's 500-stock index and Nasdaq both plunged more than 3 percent.

It's been a grim time for cleantech investors. Prior to Tesla, there hadn't been a U.S.-based initial public offering since **A123 Systems**, a maker of batteries for electric cars, went public in September. With stock markets worldwide reeling, solar-panel maker **Solyndra** pulled its IPO filing on June 18, choosing instead to raise $175 million in debt.

That was only part of the reason for skepticism leading up to Tesla's first day of trading. The company has been losing money since opening for business in 2003, and Tesla says it won't see profitability for at least two years as it moves from selling $109,000 sports cars to cheaper sedans.

The Palo Alto (Calif.)-based company's shares rallied on Day One to a stock-market value in excess of $2 billion. Chief Executive Officer Elon Musk sold shares worth at least $24 million. The strong showing had investors seeing a window of opportunity for more "liquidity events," to use a Silicon Valley term for IPO. "It really lubricates the way," says Nat Goldhaber, managing director of **Claremont Creek Ventures** in Oakland, Calif., which invests in energy-conservation companies. "You'll see a rush of bankers and companies trying to push through new green-based IPOs."

No one knows which cleantech company might go public next, but the likeliest are those that, like Tesla, have raised tremendous amounts of money–and thus need to find a way to pay back investors. Fuel-cell manufacturer **Bloom Energy**, biofuel producer **Sapphire Energy**, and solar companies **eSolar** and **BrightSource Energy** each have raised at least $100 million in venture capital. **Better Place**, which is trying to build a network of battery-swapping facilities–sort of like filling stations for electric cars–raised $350 million in May.

For these and other cleantech companies, the Tesla IPO "is a real confidence builder," says Gary Bloom, the CEO of **eMeter**, which makes software to help utilities manage data and bolster energy efficiency. EMeter has raised more than $70 million. While the decade-old company isn't preparing for an IPO, Bloom says, Tesla's success is "proving that things are moving in the cleantech sector and that there's real deliverables."

Bloom is quick to caution against reading too much into Tesla's opening-day gains. After A123 raced out of the gates on Sept. 24, the stock proceeded to lose half its value over the next nine months and continues to sell below its offer price. —*Ari Levy and Lee Spears*

The bottom line *Tesla's initial public offering may be a "real confidence builder" that paves the way for more cleantech IPOs.*

Tesla has sold more than 1,000 of its $109,000 Roadsters so far



Innovator

Howard S. Jonas



The telecom company he founded, IDT, lost 99 percent of its value. Now, Jonas is counting on Colorado oil shale for his comeback

Howard S. Jonas holds a jagged rock that smells like the floor of an auto-repair garage. It's oil shale. Jonas, a lanky 54-year-old, sees it as the future of **IDT**, the Newark (N.J.)-based telecom company he founded in 1990. IDT's stock fell 99 percent between early 2004 and late 2008, bottoming at 66¢ a share, as telecom soured and the company lost half a billion dollars. Since then it has zoomed back up, to $12.75 on June 29, thanks to enthusiasm for IDT's oil-production experiment in western Colorado. Says Jonas: "This is the richest shale in the world."

Oil shale has broken many hearts. It doesn't contain oil but kerogen—a low-energy, solid substance that must be heated to 600F to 700F before it turns into oil and bleeds out of the rock. Mining and heating shale are costly and energy-consuming and leave behind piles of waste. Companies are experimenting with heating the shale while it's still underground and then pumping the oil to the surface, but that increases the risk of groundwater contamination.

Jonas says his approach is clean and energy-efficient: Capture the combustible gas that comes out of the ground with the heated oil, inject it back into the ground, and burn it. That should heat up and crack more shale, yielding additional oil and gas in what Jonas hopes will be a self-sustaining process. He plans to extract oil only from a layer of shale 2,000 feet below the earth's surface. That's beneath the water-rich layers known as aquifers, minimizing the risk of drinking-water contamination. (**Royal Dutch Shell**, which does plan to seek oil in the aquifer layer, has devised a complex method of freezing the ground around the heated shale to keep water away from oil.)

The technology comes from EGL Oil Shale of Glenwood Springs, Colo. IDT acquired 75% of EGL in 2008 and renamed it American Shale Oil. Last year, Jonas brought in France's **Total** as a 50-50 partner. The venture will test the extraction method on a 160-acre plot of federal land in northwestern Colorado. The Bureau of Land Management is giving the company 10 years to show what it can do.

It will take that long to know if Jonas' latest adventure will pay off. Adviser M. Nafi Toksoz, a Massachusetts Institute of Technology geophysicist, says "it's hopeful but never for sure." David Abelson, a policy adviser to environmental group Western Resource Advocates in Boulder, Colo., says shale oil is a "looking-in-the-rearview-mirror fuel source," and the U.S. should focus on clean renewables.

Jonas, an avid supporter of Israel, is developing shale oil there through a separate venture chaired by Michael Steinhardt, who made his fortune in hedge funds. Steinhardt sees his investment as a way to do good and make money at the same time. "On those kinds of investments," Steinhardt says with a laugh, "I have a near perfect record—of failure." Not what Jonas was hoping to hear. —*Peter Coy*

Background ▶ **Bronx-born and -raised; married with nine children**

Prior Jobs ▶ **Internet entrepreneur, movie producer, hot dog vendor**

Politics ▶ **Quotes Ronald Reagan and is friends with Dick Cheney**

Technology

World Cup

Silencing the New Sound of Soccer

▶ **Muting the buzz of vuvuzela horns is a growth industry**

▶ **"I became really annoyed by the vuvuzela sound"**

Vuvuzelas—those plastic horns bleating in the background at every World Cup soccer match—have created an industry: vuvuzela fighters. Broadcasters are doing what they can to reduce the noise, and they knew the horns would be a problem even before the first ball was kicked. "We learned from the Confederations Cup [in South Africa last year]," says Niclas Ericson, director of the TV division at FIFA, the governing body for international soccer. "We are still working to improve the sound." Even so, **ESPN** and Britain's **BBC** both say they have had complaints from fans, though they're reluctant to entirely mute the sound of the horns for fear of losing the atmosphere of the matches. For Nascar races, "we cut [the motors] way down, because if that's all you hear, it's not a great experience," John Skipper, ESPN's vice-president of content, said in a conference call with reporters on June 14. "We're doing the same thing" at the World Cup.

Others are offering do-it-yourself options to the vuvuzela-phobic. **Elgato**, the maker of EyeTV software that lets Mac users watch television online, has added a feature to reduce the noise. On June 12, German sound engineer Clemens Schleiwies launched a website called antivuvuzelafilter.com offering $3.60 downloads of an MP3 file that he says viewers can play on their stereo to cancel out the sound of the horns. And on June 14, Parisian Benoît Rigaut opened vuvuzelafiltering.com, a compendium of tips on cutting the noise from TV broadcasts. One idea: If your TV has an equalizer, drop the 300Hz band as low as possible. "I became really annoyed by the vuvuzela sound," Rigaut said in an e-mail. "It was really obvious that sound filtering was the only way to go."

Some think the vuvuzela buzz isn't all bad. On June 23, a vuvuzela button



FROM LEFT: PHOTOGRAPH BY DEAN KAUFMAN FOR BLOOMBERG BUSINESSWEEK; EVA-LOTTA JANSSON/CORBIS

appeared on Youtube, allowing users to add the sound to videos. A Dutch company called **Moblio.nl** created a vuvuzela app for the iPhone and iPad after last year's Confederations Cup. Since the World Cup started in June, interest has spiked, and the app has been downloaded more than 4.5 million times. "We thought it would be popular," says Moblio.nl co-founder Lyan van Furth, "but not like this." —*Chris Prentice*

The bottom line *Net entrepreneurs and broadcasters are helping viewers reduce the buzz of vuvuzela horns, though some fans say they like the sound.*

Music Industry

Fewer Downloads Mean Flatter Profits

- ▶ **Digital sales hit the wall as listeners turn to streaming services**
- ▶ **"It could take 200 streams to make up for a single download"**

After learning to live with less profitable digital sales in the post-CD era, the music industry is getting hit again. Downloads of songs to iPods, computers, and other devices have stalled, researcher Nielsen SoundScan reports, growing just 0.3 percent this year. Even worse for music companies, an earlier digital moneymaker, ringtones, peaked in 2007 at $714 million and have since fallen 24 percent, according to the latest data from researcher SNL Kagan. "Digital downloads are clearly becoming a mature part of the business," says Howard Bass, a senior partner at Ernst & Young who advises entertainment companies. "The question is how quickly the music industry can adopt a new digital strategy."

The number of music enthusiasts using iTunes, **Amazon.com**, and other digital music stores has leveled off at about 40 million people, market researcher NPD Group reports. Audiences increasingly are turning to ad-supported streaming sites such as **Pandora** (page 39). While growth in downloads may pick up this year, PricewaterhouseCoopers says, it won't be enough to keep the overall industry from shrinking. U.S. sales of all kinds of recorded music—CDs, downloads, and other formats—will fall to $7 billion in 2012, or a bit more than half their level in 2005, before climbing slowly, according to PWC. "The days when people were building their digital collections or might hear a song and buy digitally are diminishing," says Russ Crupnick, an analyst at NPD.

The major labels are scrambling

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Technology



Why crude prices are heading lower page 43 ▶

to come up with alternatives. The industry's leaders, **Universal Music** and **Sony Music Entertainment,** are among the backers of **Vevo**, an ad-supported streaming website. No. 3 **Warner Music Group** wants new acts to sign what the industry calls "360 deals," which generate revenue from music, merchandise, and concert sales. All the big labels have licensed songs to subscription services such as **Rhapsody** and **Rdio**. The problem is those services are far less profitable than sales of individual tracks. "It could take 200 streams to make up for a single download," says Robb McDaniels, chief executive officer of **INgrooves**, which distributes music online.

To squeeze more money from downloads, the big labels last year persuaded **Apple** to raise prices from 99¢ to $1.29 for the newest hit tunes. Warner in February said the higher price may have contributed to slower growth in downloads last year, though its overall digital music revenue grew by 12 percent in the quarter ended in March. Universal says revenue for its stable of artists such as U2, Justin Bieber, and Lady Gaga fell by 1.7 percent in the quarter ended Mar. 31, largely a result of weak ringtone sales.

One area that continues to grow at a troubling rate is pirated music. "This isn't a mature market, it is a market that's getting pirated," contends Strauss Zelnick, former chairman of **Columbia Music Entertainment**. Still, Zelnick concedes that value-minded consumers who might have spent money to download their tunes have gone elsewhere. "When disposable income is tight," he says, "a lot of them would rather spend for things like video games that can't be pirated."

—*Ronald Grover and Adam Satariano*

The bottom line *As digital downloads slow, the music industry is scrambling for a strategy to keep revenues rolling in.*

115

MILLION DOLLARS

Valuation of New York-based social network Foursquare, which just raised $20 million in venture capital. The company was founded last year.



Online Commerce

Meet the King Of Dot-XXX

▶ **ICM Registry may become the one place to buy porn Web addresses**

▶ **"This looks like a step toward the end goal of censorship"**

The Internet has made Stuart Lawley a wealthy man. In 1999 he got rich by taking a British Internet service provider public. The *London Sunday Times* has named him one of the 1,000 richest people in Britain.

Now he's poised to make his next fortune—selling Internet addresses to pornographers. Late last month the Internet Corporation for Assigned Names and Numbers (ICANN), an international body that manages Web addresses around the world, gave preliminary approval for Lawley's application to be the sole registry of Internet domains that end in dot-xxx.

If Lawley's bid is approved—ICANN's next board meeting is in December—he says his company, **ICM Registry**, stands to bring in $200 million a year selling Web addresses at $60 a pop. That's six times the going rate for dot-com and dot-net addresses, but in line with niche domains such as dot-travel and dot-jobs. Lawley also has plans to open a payment business similar to **PayPal** for dot-xxx sites, which he says could process $3 billion to $4 billion in transactions a year. "It was crystal clear that a domain for the adult industry was going to be very successful," says Lawley, who now lives in Jupiter, Fla.

Lawley first tried to get ICANN to recognize dot-xxx as a domain in 2004. ICANN Chairman Peter Dengate Thrush says the organization rejected Lawley's application because he didn't have enough support in the adult-entertainment industry. Six years, $6 million in legal fees, and a lot of porn-industry lobbying later, an independent arbitrator ruled that ICANN had acted improperly in rejecting the proposal, clearing the way for Lawley's dot-xxx ambitions.

Lawley, who is otherwise uninvolved in the pornography industry, says he plans to regulate the domain through a seven-person board, including seats reserved for porn industry players, privacy experts, and child-protection and free-speech advocates. He says making dot-xxx a clearly defined zone for adults out of the reach of minors and as free as possible from fraud or malicious computer viruses will make it a more appealing venue for consumers. That, he hopes, will attract businesses who'll buy domain names from him. "The adult industry has tended to work in isolation," says Lawley. "Most of them operate legal sites and take reasonable [precautions], but nobody knows that. Under dot-xxx, everyone will know that."

An unlikely alliance has formed against Lawley. Christian groups such as the Family Research Council oppose the dot-xxx initiative because it legitimizes porn. And some adult sites say it will add to operating costs and open the industry to more regulation. "It's a business annoyance for us," says John Sander, vice-president of marketing and business development at **Kink.com**, which shoots bondage films in a converted San Francisco armory.

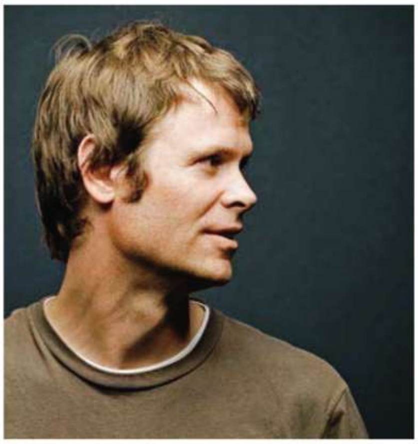
Sander has already begun preregistering dot-xxx versions of Kink's "several thousand" Web addresses (30 main sites, plus misspellings and any other permutations that might bring traffic) with ICM Registry to make sure no one else snatches up the company's brands. Yet Sander still worries about what corralling his company into a corner of the Internet could mean down the road. "It's a red flag," he says. "This looks like a step toward the end goal of censorship." **B**

—*Joseph Galante with Kristen Schweizer*

The bottom line *ICM Registry says its position as the sole purveyor of dot-xxx addresses may bring it $200 million in sales per year.*

Charlie Rose talks to

Tim Westergren



Tim Westergren is founder of Pandora, an Internet radio station and recommendation engine with 54 million users. Plug in a song title, and you'll hear others with the same DNA

Suppose I put in the name of an album you would know, *Kind of Blue* from Miles Davis. You would type me a certain way. And suppose my next album was *Nebraska* from Bruce Springsteen.
So you're creating a second station. On Pandora, you can create up to a hundred different channels or stations.

"Station" in this case means ... ?
It's a sequence of songs. Radio is not quite the right word. But it's a stream of music based on this input that you started with.

So you began to get advertisers, and you began to get subscribers.
Right. We launched it briefly as a subscription-only service but fairly quickly migrated to a free offering and a subscription offering.

If it's free, why would I want a subscription?
To get rid of ads. Most listeners are free users; a small percentage subscribe.

Do you believe the advertising model is going to prevail on the Web, or will people begin to create some kind of pay walls? You know, this is the burning question for everybody.
Advertising-supported free is certainly going to be the dominant paradigm for the Web. I think there are a small number of companies that have the brand and content to command subscription. You can count them on a couple hands, though.

What distinguishes them?
It's high-quality, original content. You know, cable is an example of that. And I think in the news world, some publications have such consistent high-quality information that they can command a subscription.

And people who advertise on Pandora are looking to reach what kind of audience?
If you're a car or a beverage company, you can come to Pandora and say I'd like to put this advertisement in front of men in their 30s listening to rock music in Kansas. And Pandora would be able to target your advertising. That's really the long-term promise of this kind of a platform.

What has the iPhone and related devices done for Pandora?
It's impossible to overstate. The iPhone has ... almost doubled our growth rate overnight. More important, perhaps, it changed the way consumers perceived Pandora. Most people came to Pandora on a laptop, principally at work. When the iPhone came out, suddenly you could take Pandora with you. You could go to the gym and be on the treadmill. Or you could buy a $2 adapter and plug it into your car.

And you didn't have to download songs from anywhere else.
Yeah. Streamed music, and you could curate it in real time. [Apple has] redefined our entire industry.

What has the iPad done?
The iPad's a whole new really interesting option for us because it gives you the opportunity to put information adjacent to Pandora so you can be listening and reading as you would with an album cover when you were younger.

Might you provide other kinds of information? Like, could you stream news if you wanted to—so I could listen to music and read news at the same time?
Or you're listening to a band, and you could learn that band is playing a concert nearby.

Where are you going to be in 2020?
I would like Pandora to be a global company. Currently, we're only available in the U.S., which is profoundly frustrating. We're trying to crack that nut ... and I hope we have a billion listeners around the world and ... [change] the radio experience for people.

I didn't know people left music.
As people get older—by that, I mean into their 20s—get a job, have a family, time gets a little bit tight, and they really lose their connection to music. Your CD collection gets stale; music becomes wallpaper. They don't lose their love of it, but it's harder to stay fresh and engaged. One of the reasons Pandora's growing so fast is that people are rediscovering a passion—they're learning about new bands. We play the music of 90,000 artists. We have three-quarters of a million songs.

Are you planing to go public?
You know, going public is a fund-raising tactic. If it made sense, we'd sort of think about it, but there's no specific plan there at all. I will say that I think we have the potential to build an enduring standalone company, and that's our principal focus. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

CLOCKWISE FROM TOP LEFT: HENRIK WEIS/GETTY IMAGES; MITCH TOBIAS; BRAD TRENT; TERENCE LANGENDOEN/GETTY IMAGES



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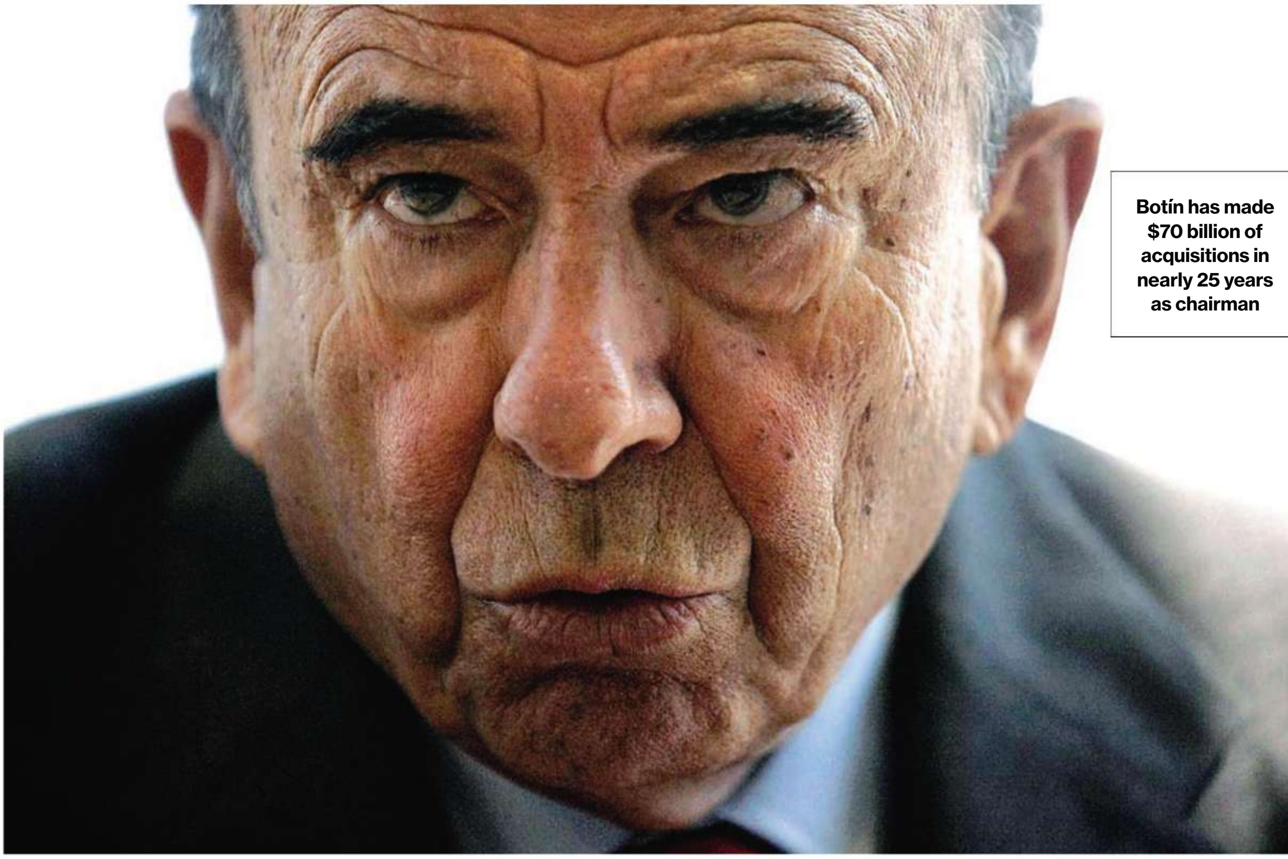
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Botín has made $70 billion of acquisitions in nearly 25 years as chairman

DANNY ALVEAL/EPA/CORBIS

The Surprising Strength Of Spain's Santander

▶ **Amid the Spanish debt crisis, the bank is showing its financial muscle at home and abroad**

▶ **"Why shouldn't they continue to conduct business as usual if opportunities arise?"**

In his almost quarter-century as chairman, Emilio Botín has built **Banco Santander** into the euro region's most valuable bank, in part by engineering more than $70 billion of acquisitions. Now he's pursuing more deals, even as global investors shun Spanish banks, concerned that the country will struggle to control its budget deficit, which ballooned to 11.2 percent of gross domestic product last year.

The 153-year-old institution is bidding for the German consumer unit of Sweden's **SEB** and 300 U.K. branches of **Royal Bank of Scotland**. In June it agreed to buy back almost a quarter of its Mexican unit from **Bank of America** for $2.5 billion, as well as purchase $3.2 billion of auto loans from **Citigroup**. "Why shouldn't they continue to conduct business as usual if opportunities arise and they don't think they have any issues with solvency?" asks Kevin Lilley, who manages about $1.5 billion in Continental European shares, including Santander, at Royal London Asset Management.

Santander navigated the financial crisis without an unprofitable quarter after avoiding U.S. subprime debt. As well as diversifying into markets beyond Spain, the bank stuck to a basic business model that has it earning about 70 percent of its profit from retail operations. At the same time, Bank of Spain regulations meant it and other Spanish lenders had to build up reserves in good times to cover future losses.

Botín, 75, told shareholders in June that the bank will earn about as much in 2010 as it did in 2009, when profit totaled $10.9 billion. Botín and other Santander executives would not comment for this story.

The stress tests being conducted on European banks may provide further evidence of Santander's solid position. "I'm confident San-

tander will fare very well in the stress tests," says Daragh Quinn, an analyst at Nomura International in Madrid, "especially bearing in mind that only a third of its loan book is in Spain."

Juan Inciarte, Santander's head of strategy, said at a seminar in Madrid this month that growth and diversification are "in the DNA" of the bank. It was founded in 1857 in the northern Spanish port of the same name to finance trade with Latin America.

Under Botín, the scion of a dynasty that's helped run the bank for 115 years, Santander has grown from the sixth-largest lender in Spain, with 700,000 clients, to a company with 92 million customers and the biggest market value of any bank in the 16 nations sharing the euro. Botín led the expansion by buying lenders in Brazil and the U.K. and stretching Santander's reach across nine main markets. That breadth helped it weather Spain's economic slump. Brazil will contribute more to Santander's profit than Spain for the first time this year, Botin told shareholders on June 11.

Among deals under consideration, Santander is trying to resurrect talks to combine its **Sovereign** unit, a retail bank in the U.S., with **M&T Bank**, also a regional American lender, after negotiations collapsed in May, three people familiar with the situation said last week. Joining the businesses would create a lender with about $140 billion in assets and 1,470 branches in the northeastern U.S.

The bank says it doesn't make purchases simply to expand its empire. "The strategic and financial criteria for acquisitions mean that Santander only carries out a transaction when it is sure it will create value for shareholders," says a Santander spokesman who declined to be identified, in keeping with company policy. "Santander is making bolt-on acquisitions in markets it knows, and that's exactly what a big and well-capitalized bank should be doing when there are opportunities," says Arturo de Frias, an analyst at Evolution Securities in London, who rates the bank a buy.

The bank also has taken steps to increase its market share at home. It added $36.6 billion in deposits this year by offering Spanish customers an annual interest rate of 4 percent, well above what competitors were paying. **Banco Bilbao Vizcaya Argentaria**, the country's second-largest bank, reported a 6.9 percent decline in its deposit base in Spain and Portugal in the first quarter. "Santander clearly took the view that [other banks] would chase this deposit funding and they would get in there first," says Claire Kane, an analyst at MF Global in London, who rates Santander a buy.

The bank hasn't been immune to investors' concerns about Spain's economy and finances: Its stock has dropped 27 percent since the beginning of the year. That may make it harder to finance acquisitions with equity, the currency it has used to buy banks, including the U.K.'s **Abbey National** in 2004.

As for Botín, there's no sign he'll be stepping aside anytime soon: He took over when his father resigned as chairman in 1986, at the age of 83. His eldest daughter, Ana Patricia Botín, 49, who runs **Banco Español de Crédito**, a Spanish consumer bank owned by Santander, has been mentioned as a possible successor. —*Charles Penty*

***The bottom line** Having avoided big losses on subprime debt, Banco Santander has the wherewithal to continue growing by acquisition.*

1.17

TRILLION DOLLARS

The value of global debt offerings in the first half of the year, 39 percent less than the same period in 2009

DATA: BLOOMBERG

Drawing Board



ILLUSTRATION BY GARY VARVEL/THE INDIANAPOLIS STAR/CREATORS SYNDICATE

Financial Reform

The New Rules Won't Stop the Next Crisis

- **Six companies will still dominate the U.S. banking industry**
- **"I'd have to imagine the Wall Street firms are pretty happy"**

The financial reform bill will change the way banks do business in everything from credit cards to credit default swaps. What it won't do is fundamentally reshape Wall Street, and it doesn't seem likely to prevent bad bets by bank-



Esther Duflo: Radical empiricist page 56 ▶

ers from causing another crisis. The legislation is "largely a fig leaf," says Dean Baker, co-director of the Center for Economic & Policy Research in Washington. "Given where we were when this got started, I'd have to imagine the Wall Street firms are pretty happy."

The overhaul allows banks to remain in the profitable derivatives business and won't shrink those deemed "too big to fail," leaving largely intact a U.S. financial industry dominated by six companies with a combined $9.4 trillion of assets. The changes also do little to address the danger posed by banks relying on the fickle credit markets for funding that can evaporate in a panic, like the one that spread in late 2008.

A deal reached by members of a House and Senate conference just after dawn on June 25 diluted provisions from the tougher Senate bill, limiting rather than prohibiting the ability of banks to trade derivatives and invest in hedge funds or private equity funds. Senator Scott Brown (R-Mass.) made his support conditional on a loosening of restrictions on hedge fund and private equity fund ownership by banks. Brown won another concession when he demanded that the committee remove a $19 billion fee on banks and hedge funds that had been tacked on at the last minute. The June 28 death of Senator Robert C. Byrd (D-W. Va.), who supported the bill, means a final vote won't take place until mid-July.

Senator Blanche Lincoln (D-Ark.) had originally advocated forbidding banks from trading swaps if they receive federal support such as deposit insurance. That could have forced banks to spin off those businesses. In the final legislation, bank holding companies such as **JPMorgan Chase** and **Citigroup** will be required to move less than 10 percent of the derivatives in their deposit-taking banks to a broker-dealer division over the next two years. **Goldman Sachs** and **Morgan Stanley**, the two biggest U.S. securities firms before they converted into banks in 2008, have smaller deposit-taking units and already hold most of their derivatives in their broker-dealer arms. The derivatives rules are "nowhere near as bad as what the banks might have feared," William T. Winters, former co-chief executive officer of JPMorgan's investment bank, told Bloomberg Television on June 25.

Another portion of the legislation that was amended in the final conference was the so-called Volcker rule, named for Paul A. Volcker, the former Federal Reserve chairman who championed it. Originally the rule would have prevented any systemically important bank holding company from engaging in proprietary trading, or betting with its own money, as well as investing its own capital in hedge funds or private equity funds.

In the final version, the banks will be allowed to provide no more than 3 percent of a fund's equity and will be limited to investing up to 3 percent of their Tier 1 capital—which includes common stock, retained earnings, and some preferred stock—in hedge funds or private equity funds. That represents a ceiling of about $3.9 billion for JPMorgan, $3.6 billion for Citigroup, and $2.1 billion for Goldman Sachs, according to the companies' latest quarterly reports.

Further diluting its impact, the Volcker rule doesn't take effect for 15 to 24 months after the law is passed. Then the banks have two years to comply, with the potential for three one-year extensions after that. They could seek five more years to withdraw money from funds that invest in "illiquid" assets such as private equity and real estate, says Lawrence D. Kaplan, an attorney at Paul, Hastings, Janofsky & Walker in Washington. "I don't think it will have any impact at all on most banks," Winters said of the amended Volcker rule.

$9.4
TRILLION

Assets controlled by the six largest U.S. banking companies

Some provisions of the new law may require banks to raise more capital as a buffer against setbacks. But they will still be able to borrow heavily in the short-term credit markets to fund their operations, rather than rely on deposits, which are more stable. Their dependence on market-based funding made firms like Goldman Sachs and Morgan Stanley vulnerable to the panic of 2008. "Something has to be put in place to cause banks to have deposit-based liabilities and not market-based liabilities," says Benjamin B. Wallace, a securities analyst at money manager Grimes & Co.

The legislation will make the financial system safer, says James Ellman, president of Seacliff Capital, a hedge fund that specializes in financial industry stocks. Even so, he says, "It won't satisfy anybody who wanted really strict additional regulation of banks."
—*Christine Harper and Bradley Keoun*

The bottom line *The financial reform bill imposes a raft of new rules, but critics say it does not go to the heart of the problems that created the crisis.*

Commodities

Oil Prices: Down And Heading Lower

▶ Weak global demand more than offsets the Gulf disaster

▶ Price per barrel



DATA: BLOOMBERG

The worst oil spill in U.S. history was not enough to prevent crude oil prices from falling nearly 10 percent over the past three months—the first quarterly drop since 2008—as the sluggish world economy kept a lid on demand. With growth expected to remain weak, prices may keep moving lower through 2010. "Getting out of the worldwide recession was always going to be a long slog," says Adam Sieminski, chief energy economist at Deutsche Bank in Washington, who predicts oil will average $65 a barrel in the third quarter and $70 in the fourth. "It's always been our view that the second half of 2010 was going to be a tough period." Crude oil ended the month of June at $75.63 a barrel.

Anemic global growth led the U.S. Energy Dept. in June to trim its crude oil demand and price forecasts for 2010. World demand will average 85.51 million barrels a day this year, the department estimates, up from 84.01 million barrels last year; global demand peaked at 86.14 million barrels a day in 2007. The department's latest forecast calls for West Texas Intermediate oil to average $78.75 a barrel this year, down from the May forecast of $82.18.

Quoted

"I think the stress test in Europe will do the same thing that the U.S. stress tests did last year."
—Bill Miller, chief investment officer of Legg Mason Capital Management. Since the results of the U.S. stress tests were released on May 7, 2009, bank stocks have outperformed the market.



The sinking of the Deepwater Horizon rig on Apr. 22 hasn't changed the supply/demand equation. In response to the accident, the Obama Administration in May imposed a six-month moratorium on deepwater drilling permits. A federal judge lifted the order on June 22, and the Administration is appealing. If the moratorium is reinstated, U.S. crude output will be cut by an average of 26,000 barrels a day in the fourth quarter of this year and 70,000 barrels a day in 2011, according to the Energy Dept.—an amount equal to less than 1 percent of daily global oil production.

"Supplies are certainly adequate given the weakness in Europe and elsewhere in [developed nations]," says Addison Armstrong, director of market research at Tradition Energy, a procurement adviser. "Whatever will be lost here because of the moratorium ... will be more than offset by OPEC spare capacity." OPEC still has the ability to pump an additional 5.46 million barrels a day.

Of course, energy markets are subject to sudden shifts. The summer driving season might push up prices, and there's always the chance that an active hurricane season could disrupt production, further curtailing supply. The fragile state of the world economy, though, remains the dominant force in the market. "The underlying fundamentals haven't changed," says Rick Mueller, director of oil markets at Energy Security Analysis in Wakefield, Mass. "There will remain a tremendous amount of crude available." —*Mark Shenk*

The bottom line *The biggest oil spill in U.S. history is having less impact on prices than weak global demand and spare OPEC production capacity.*

Money Managers

Hedge Fund Stars Start Grooming Successors

- The aim: To keep clients from fleeing when the big names leave
- Funds are tied to "their charismatic and entrepreneurial founders"

An older generation of hedge fund heavyweights, including Julian Robertson and Michael Steinhardt, shut their firms after deciding they no longer wanted to invest money for clients. Some of today's most successful hedgies are surrounding themselves with experienced traders in an effort to keep clients from pulling out after they stop running the funds.

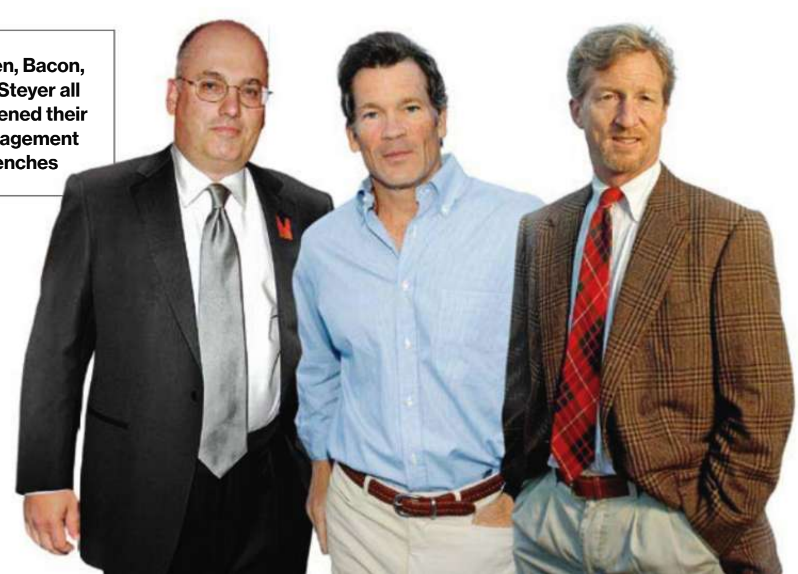
Steven A. Cohen, the 54-year-old founder of **SAC Capital Advisors**, picked four people from his staff earlier this year to help choose investments for the $2 billion he personally oversees at his firm. Louis Bacon, 53, bolstered the ranks at **Moore Capital Management**, which he founded in 1989, by recruiting four senior managers in the past 20 months, while Thomas Steyer, 53, designated Andrew Spokes as his likely successor in the event he leaves **Farallon Capital Management**, which he founded in 1986.

Persuading investors to stay after founders depart will be a challenge, according to Jean Keller, chief executive officer of Geneva-based 3A, which has $2.2 billion invested in hedge funds on behalf of clients. "Most of them are intrinsically linked to their charismatic and entrepreneurial founders," says Keller. "Few hedge funds will succeed in a management transition."

John Horseman, 51, who started **Horseman Capital Management** in 2000, told clients in November that he would step down this year, leaving fund managers Russell Clark and John-Paul Burke at the helm. Assets in Horseman Global, the London-based firm's biggest fund, fell to $444 million in May from $3.67 billion in October, mainly because of client withdrawals, according to an investor in the fund. Spokesmen for Horseman and the other hedge funds mentioned in this story declined to comment.

Cohen started SAC in 1992 with $25 million and now has $12 billion under management. Naming the four senior traders will allow Cohen to focus on fewer investments, mentor employees, and manage risk, according to an Apr. 28 letter sent to investors. At Moore Capital, among the four senior people Bacon brought in was Greg Coffey, 39, a top-performing emerging-markets trader at hedge fund **GLG Partners**. His resignation from GLG in late 2008 triggered $2.2 billion in withdrawal requests. Matthew Carpenter, 43, who ran a **Citigroup** unit that traded U.S. stocks with more than $1 billion of the bank's own money, joined in May as Bacon's head of equity trading. At Farallon, Co-Managing Partner Spokes was named the firm's second so-called key man at the beginning of the year. That means investors have the right to withdraw their money if either manager leaves the firm.

James Simons and David Shaw are examples of big-name hedge fund founders who engineered their own exits without



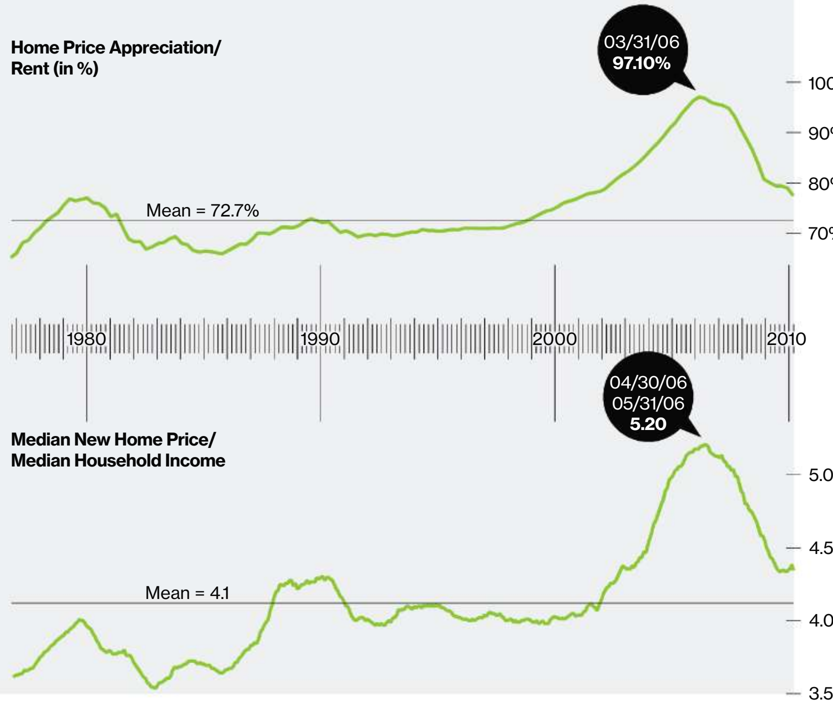
Cohen, Bacon, and Steyer all deepened their management benches

CLOCKWISE FROM TOP: BLOOMBERG; MICHAEL SEXTON; PATRICK MCMULLAN (2)

Real Estate

House Prices Are Still Too High

Homes in the U.S. remain overpriced based on two key measures—their relationships to incomes and rents, as these charts show. And they may have a lot further to fall, according to Barry Ritholtz, CEO of money manager Fusion IQ. "If you have a market that's that far out of whack, you don't just revert back to the mean," he says. "There is a tendency to shoot below it." —*Caroline Winter*



DATA: NED DAVIS RESEARCH

shutting their companies. Simons, the 72-year-old mathematician who began **Renaissance Technologies** after leaving academia in 1977, retired last year and turned over responsibility for the firm to former Co-Presidents Robert Mercer, 63, and Peter Brown, 55. Shaw, who started **D.E. Shaw** in 1988, ceded oversight of his firm to a six-person committee in 2002, when client assets were $2.36 billion. The firm has grown to $22 billion. Both firms use computer models to trade, although D.E. Shaw has more than a third of its assets in discretionary investments.

Funds that built their reputations on one person's gifts may find it harder to survive their founders' exits. "It's good that veteran managers are thinking about deepening the benches, but it's not going to be easy," says Guido Bolliger, Paris-based chief investment officer of Olympia Capital Management, which invests $2.7 billion in hedge funds for clients. "While there are a lot of smart people in the hedge fund world, there are not that many geniuses." —*Saijel Kishan*

The bottom line *While hedge fund managers can build organizations to execute their investment philosophy, it's hard to impart their mystique to others.*

Wall Street

Firms Lure Bankers With Bonus Guarantees

▶ A pickup in hiring shows faith in the industry's future

▶ "The overall mood… is significantly better than it was last year"

Leverage is back on Wall Street—and now it's the bankers who have it. Companies are adding jobs for the first time in two years, rebuilding businesses cut during the financial crisis and offering guaranteed payouts to attract top bankers. "Candidates are now getting multiple offers, and companies risk losing their desired candidates if they don't act quickly enough," says Constance Melrose, managing director of eFinancialCareers North America, whose employment website has seen a 75 percent increase in investment banking job postings from a year earlier.

The removal of uncertainty surrounding Congress' financial reform bill may reinforce the hiring rebound. A deal reached by members of a House and Senate conference committee in late June diluted provisions from the tougher Senate bill, limiting rather than prohibiting the ability of banks to trade derivatives and invest in hedge funds or private equity funds. Five of the largest banks on Wall Street—**Bank of America**, **Citigroup**, **Goldman Sachs**, **JPMorgan Chase**, and **Morgan Stanley**—increased their total head count in the first quarter, the first three-month jump since the start of 2009.

New York City had 429,000 financial jobs as of May 31, up from 422,200 in February, according to the New York State Labor Dept. That's down from the peak of 473,800 in August 2007. "The overall mood on Wall Street is significantly better than it was last year," says Richard G. Lipstein, a managing director at Boyden Global Executive Search. "There has been some pent-up demand for people, and that demand follows increased optimism."

The scramble for investment bankers and traders has firms paying 30 percent to 40 percent more than what employees expect to earn this year in salary and bonus to lure them

from other banks, according to an April report from Options Group, a New York-based executive search and compensation consulting company. Equity derivatives and commodities trading are two of the fastest-growing areas, the report said.

Some companies have offered pay packages as high as $8 million, including guaranteed bonuses, which are paid regardless of an employee's or the company's performance, say recruiters. That's reminiscent of Wall Street's compensation practices during the boom, before the credit crisis forced banks to cut more than 345,000 jobs worldwide. "When markets fell to hell in a handbasket, people were lucky to get a job with a base salary, and everything else would depend on their performance," says Lipstein. "As we start to see people being recruited from one firm to another, as opposed to being recruited from unemployment, the need to make some kind of guarantee is becoming more necessary."

Leaders of the Group of 20 nations have tried to discourage banks from offering bonus guarantees for more than one year, on the theory that linking compensation with long-term success will help reduce risk. Still, even those banks that aren't providing guaranteed bonuses are telling candidates that they should expect generous payouts, say recruiters such as Ross Baltic, a managing partner at Mercury Partners. "There are firms that don't have the ability to make a guarantee or are adamantly against guaranteeing compensation," he says. "Instead, they're giving verbal guidance on what compensation may be. They're just not tying themselves down by putting something in writing."

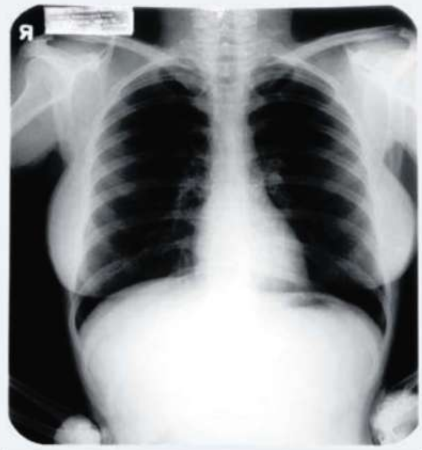
The bidding for talent is improving perks even for some bankers who don't move to new jobs, says Lee Whiteing, HSBC's U.K. travel chief. "Certainly in investment banking we're in a situation where it's an employees' market," Whiteing says. "Making them stay at cheaper properties, fly economy when they could go business, is not going to wash. They're just going to leave us and go to another institution." Ⓑ

—Michael J. Moore

The bottom line *Fading worries about financial reform legislation may reinforce banks' efforts to snare top talent with generous pay offers.*

Bid & Ask

By Cristina Lindblad



Memorabilia

A set of 1954 X-rays of Marilyn Monroe's chest and pelvis fetched **$45,000** at a Las Vegas auction of Hollywood memorabilia. The sum was far beyond the presale estimate of $800 to $1,200, indicating that some gentlemen prefer their blondes skeletal.

Telecom

$1.9bn

Amount Japan's Sumitomo is paying for a 30 percent stake in Brazilian miner Mineração Usiminas. The deal allows Usiminas, which controls several iron ore mines, plus railroads, to profit from rising demand for the steelmaking material.

Entertainment

Bob and Harvey Weinstein, the brothers behind the studio that brought *The Reader* and *Inglourious Basterds* to the big screen, reached an agreement with Goldman Sachs to retire **$450 million** in debt. Under the deal, which was first reported in *The Wall Street Journal*, the bank will take ownership of 250 films with $225 million in receivables and future cash flow.

Cars

The latest toy to roll off the line at Lamborghini's factory in Bologna carries a price tag of about **$260,000**. To create the LP 570-4 Superleggera, Lamborghini's surgeons carved 154 pounds off the three-year old Gallardo coupe. Fashioned from sheets of carbon fiber, the ultralight car rockets to 60 mph in 3.3 seconds.



M&A Roundup

The number of announced global mergers and acquisitions fell to 5,426 in the second quarter from 6,079 in the previous three months. Deal volume was down 13 percent, to **$420.5 billion.** Yet the average premium on deals—the amount bidders are willing to pay over the closing price of the target's stock on the day before a deal is announced—rose four percentage points, to 24 percent, in part reflecting vigorous competition for some choice assets.

Banking

$102mn

Amount Morgan Stanley agreed to pay to settle claims by the Massachusetts Attorney General that the company provided billions of financing to subprime lender New Century, which in turn used the funds to target low-income borrowers unfairly. Of that figure, **$58 million** has been earmarked to assist more than 1,000 homeowners in the state.

Oil

$2.16bn

Amount Noble Corp., a supplier of so-called jack-up oil rigs, has agreed to pay for drilling company FDR Holdings. Cayman Islands-based FDR is controlled by a private equity firm managed by Carlyle Group and Riverstone Holdings. Noble's move is well timed: Uncertainty around U.S. standards for deep-water drilling in the wake of the BP accident has depressed prices for companies in that field.

Shipping

In what amounts to a bet on the global recovery, Genco Shipping & Trading entered into an agreement to buy 16 Supramax vessels from Bourbon for **$545 million**. Supramax ships are giant dry-bulk carriers that ferry iron ore, coal, grain, and steel. Genco's management cited growing demand for commodities from India and China as a factor in its decision to expand its fleet.

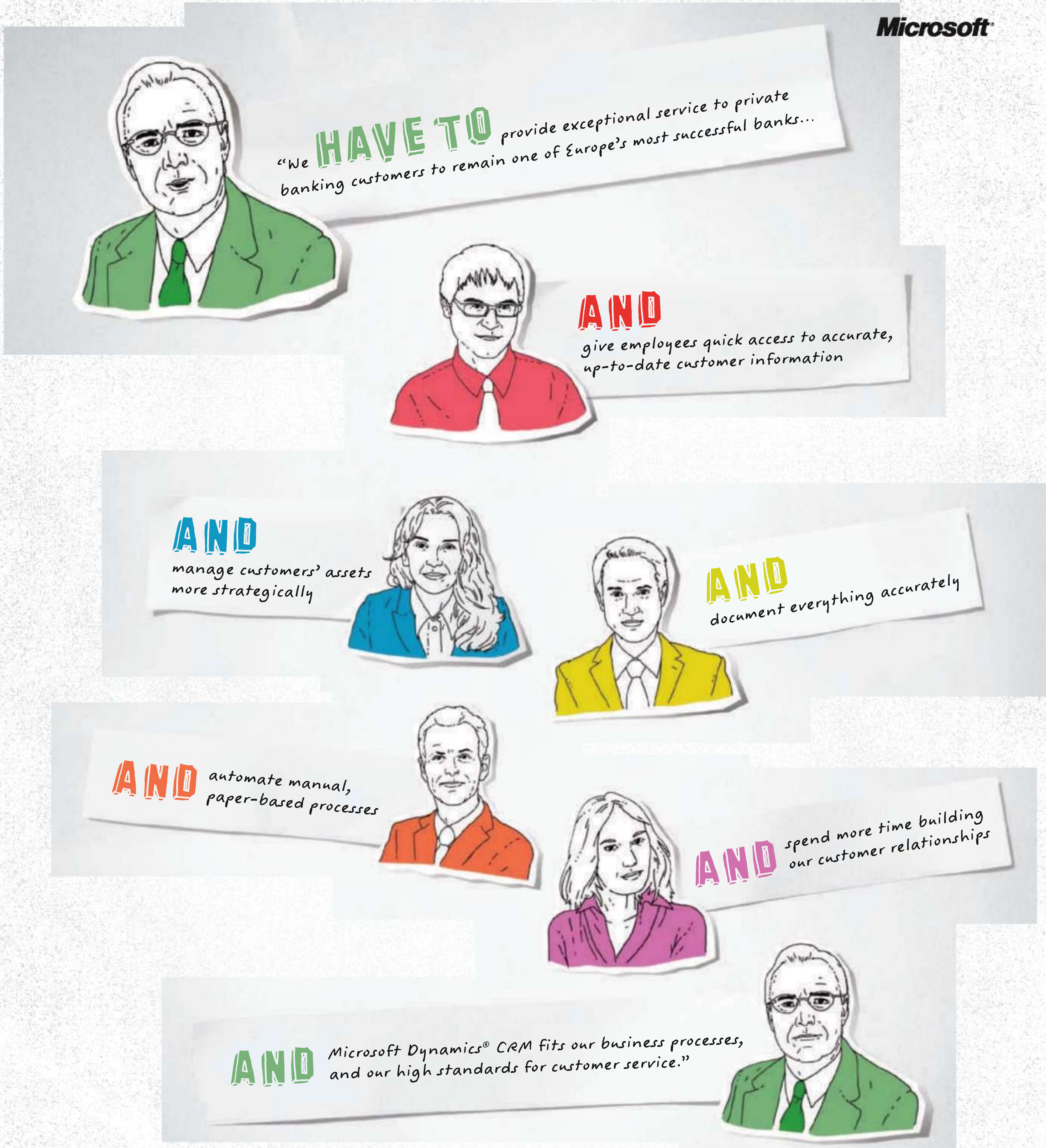
21 in.



Collectibles

The world's largest gold coin sold for **$4 million**—about four times its face value—at an auction in Vienna. Minted by the Royal Canadian Mint, the 100-kilo (220 pounds) solid gold coin is featured in the current edition of *Guinness World Records*.

FROM TOP: SPLASH NEWS; DAVID BARBOUR/BLOOMBERG; ADRIAN MOSER/BLOOMBERG



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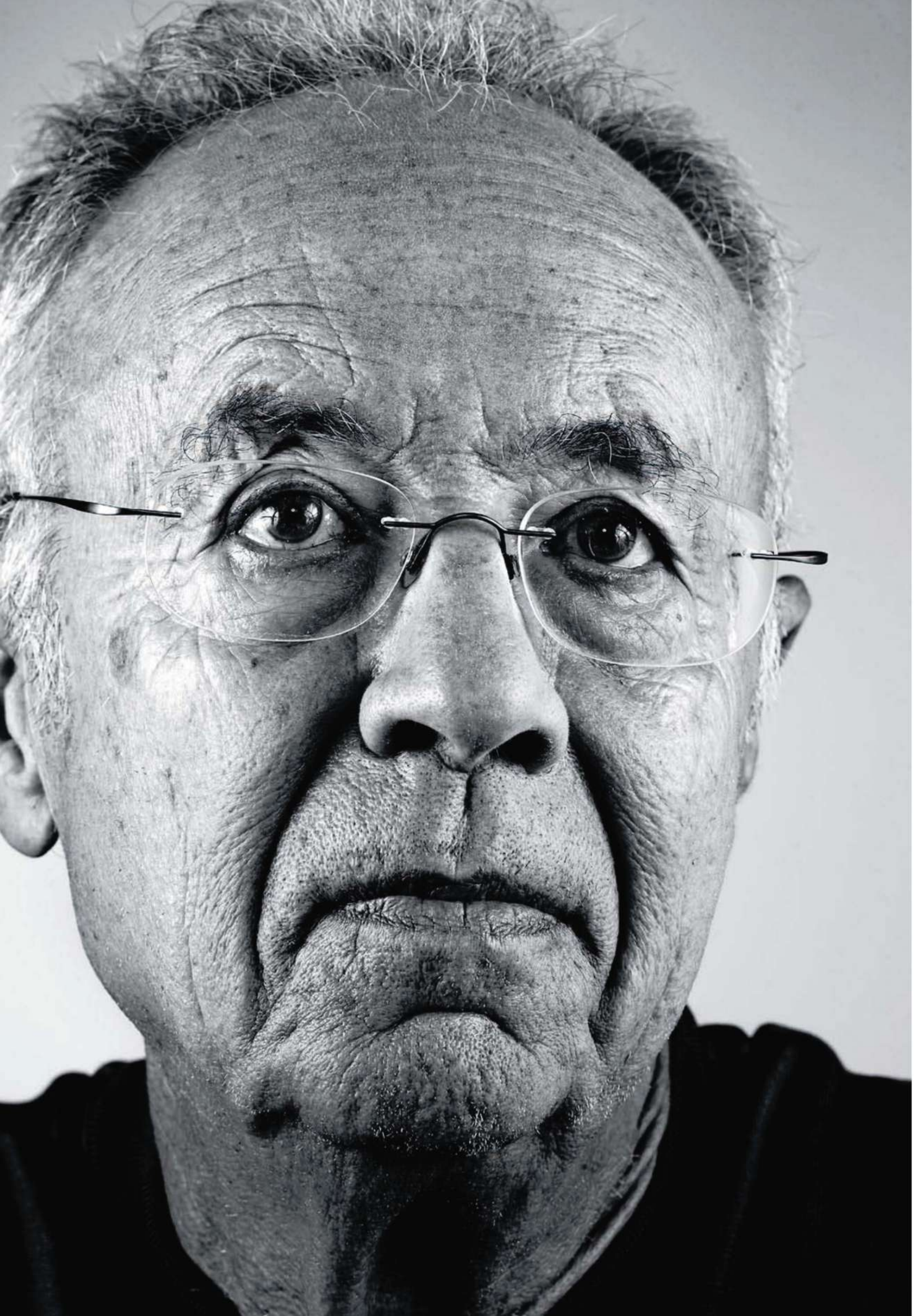
‘Startups are wonderful. But they don’t create employment.’

How to Make an American Job.

By Andy Grove



Photograph by Robyn Twomey



Recently an acquaintance at the next table in a Palo Alto (Calif.) restaurant introduced me to his companions, three young venture capitalists from China. They explained, with visible excitement, that they were touring promising companies in Silicon Valley. I've lived in the Valley a long time, and usually when I see how the region has become such a draw for global investments, I feel a little proud.

Not this time. I left the restaurant unsettled. Something did not add up. Bay Area unemployment is even higher than the 9.7 percent national average. Clearly, the great Silicon Valley innovation machine hasn't been creating many jobs of late—unless you're counting Asia, where American tech companies have been adding jobs like mad for years.

The underlying problem isn't simply lower Asian costs. It's our own misplaced faith in the power of startups to create U.S. jobs. Americans love the idea of the guys in the garage inventing something that changes the world. *New York Times* columnist Thomas L. Friedman recently encapsulated this view in a piece called "Start-Ups, Not Bailouts." His argument: Let tired old companies that do commodity manufacturing die if they have to. If Washington really wants to create jobs, he wrote, it should back startups.

Friedman is wrong. Startups are a wonderful thing, but they cannot by themselves increase tech employment. Equally important is what comes after that mythical moment of creation in the garage, as technology goes from prototype to mass production. This is the phase where companies scale up. They work out design details, figure out how to make things affordably, build factories, and hire people by the thousands. Scaling is hard work but necessary to make innovation matter.

The scaling process is no longer happening in the U.S. And as long as that's the case, plowing capital into young companies that build their factories elsewhere will continue to yield a bad return in terms of American jobs.

What Went Wrong?

Scaling used to work well in Silicon Valley. Entrepreneurs came up with an invention. Investors gave them money to build their business. If the founders and their investors were lucky, the company grew and had an initial public offering, which brought in money that financed further growth.

I am fortunate to have lived through one such example. In 1968 two well-known technologists and their investor friends anted up $3 million to start Intel, making memory chips for the computer industry. From the beginning we had to figure out how to make our chips in volume. We had to build factories, hire, train, and retain employees, establish relationships with suppliers, and sort out a million other things before Intel could become a billion-dollar company. Three years later the company went public and grew to be one of the biggest technology companies in the world. By 1980, 10 years after our IPO, about 13,000 people worked for Intel in the U.S.

Not far from Intel's headquarters in Santa Clara, Calif., other companies developed. Tandem Computers went through a similar process, then Sun Microsystems, Cisco, Netscape, and on and on. Some companies died along the way or were absorbed by others, but each survivor added to the complex technological ecosystem that came to be called Silicon Valley.

As time passed, wages and health-care costs rose in the U.S. China opened up. American companies discovered that they could have their manufacturing and even their engineering done more cheaply overseas. When they did so, margins improved. Management was happy, and so were stockholders. Growth continued, even more profitably. But the job machine began sputtering.

The 10X Factor

Today, manufacturing employment in the U.S. computer industry is about 166,000, lower than it was before the first PC, the MITS Altair 2800, was assembled in 1975 (*figure* B). Meanwhile, a very effective computer manufacturing industry has emerged in Asia, employing about 1.5 million workers—factory employees, engineers, and managers. The largest of these companies is Hon Hai Precision Industry, also known as Foxconn. The company has grown at an astounding rate, first in Taiwan and later in China. Its revenues last year were $62 billion, larger than Apple, Microsoft, Dell, or Intel. Foxconn employs over 800,000 people, more than the combined worldwide head count of Apple, Dell, Microsoft, Hewlett-Packard, Intel, and Sony (*figure* C).

Until a recent spate of suicides at Foxconn's giant factory complex in Shenzhen, China, few Americans had heard of the company. But most know the products it makes: computers for Dell and HP, Nokia cell phones, Microsoft Xbox 360 consoles, Intel motherboards, and countless other familiar gadgets. Some 250,000 Foxconn employees in southern China produce Apple's products. Apple, meanwhile, has about 25,000 employees in the U.S. That means for every Apple worker in the U.S. there are 10 people in China working on iMacs, iPods, and iPhones. The same roughly 10-to-1 relationship holds for Dell, disk-drive maker Seagate Technology, and other U.S. tech companies.

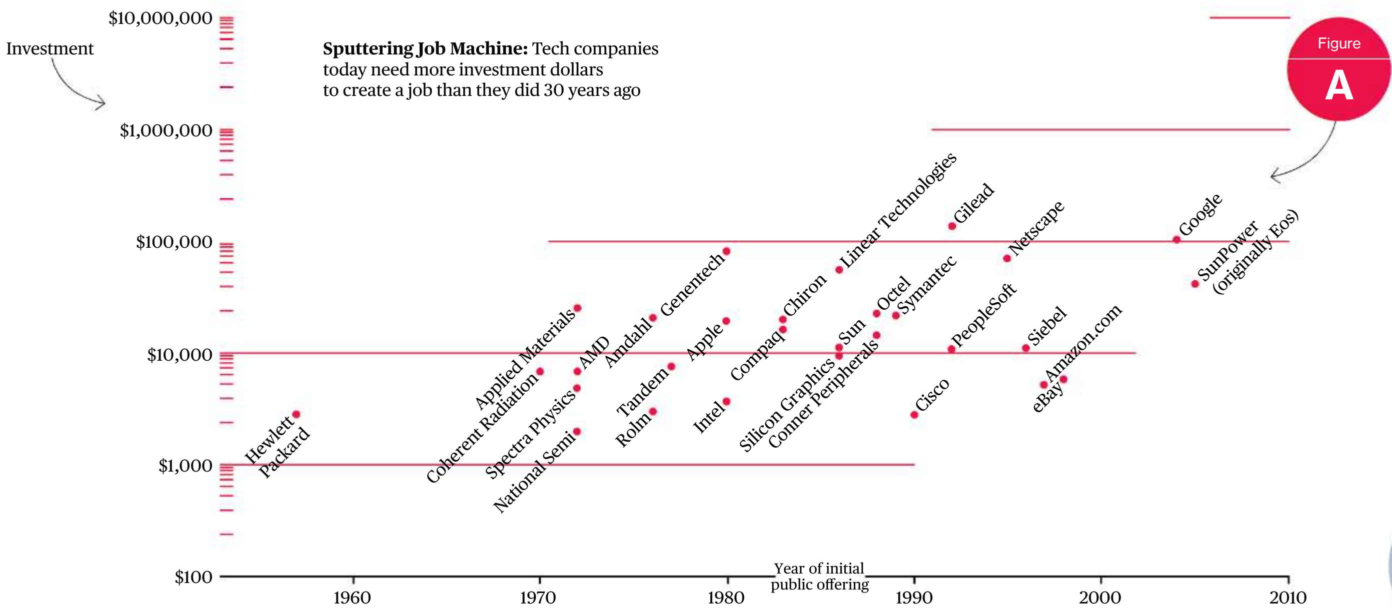
You could say, as many do, that shipping jobs overseas is no big deal because the high-value work—and much of the profits—remain in the U.S. That may well be so. But what kind of a society are we going to have if it consists of highly paid people doing high-value-added work—and masses of unemployed?

Since the early days of Silicon Valley, the money invested in companies has increased dramatically, only to produce fewer jobs. Simply put, the U.S. has become wildly inefficient at creating American tech jobs. We may be less aware of this growing inefficiency, however, because our history of creating jobs over the past few decades has been spectacular—masking our greater and greater spending to create each position. Should we wait and not act on the basis of early indicators? I think that would be a tragic mistake, because the only chance we have to reverse the deterioration is if we act early and decisively.

Already the decline has been marked. It may be measured by way of a simple calculation—an estimate of the employment cost-effectiveness of a company. First, take the initial investment plus the investment during a company's IPO. Then divide that

Andy Grove, senior adviser to Intel, was the company's chief executive officer or chairman from 1987 until 2005.

'The cost of creating jobs grew from a few thousand dollars per position to a hundred thousand today'



*Investment restated in 2010 dollars. Dollars invested before and in the IPO, divided by worldwide employment 10 years after the IPO. Data: Andy Grove

by the number of employees working in that company 10 years later. For Intel this worked out to be about $650 per job–$3,600 adjusted for inflation. National Semiconductor, another chip company, was even more efficient at $2,000 per job. Making the same calculations for a number of Silicon Valley companies shows that the cost of creating U.S. jobs grew from a few thousand dollars per position in the early years to a hundred thousand dollars today (*figure* A). The obvious reason: Companies simply hire fewer employees as more work is done by outside contractors, usually in Asia.

The job machine breakdown isn't just in computers. Consider alternative energy, an emerging industry where there's plenty of innovation. Photovoltaics, for example, are a U.S. invention. Their use in home energy applications was also pioneered by the U.S. Last year, I decided to do my bit for energy conservation and set out to equip my house with solar power. My wife and I talked with four local solar firms. As part of our due diligence, I checked where they get their photovoltaic panels–the key part of the system. All the panels they use come from China. A Silicon Valley company sells equipment used to manufacture photo-active films. They ship close to 10 times more machines to China than to manufacturers in the U.S., and this gap is growing (*figure* D). Not surprisingly, U.S. employment in the making of photovoltaic films and panels is perhaps 10,000–just a few percent of estimated worldwide employment.

There's more at stake than exported jobs. With some technologies, both scaling and innovation take place overseas.

Such is the case with advanced batteries. It has taken years and many false starts, but finally we are about to witness mass-produced electric cars and trucks. They all rely on lithium-ion batteries. What microprocessors are to computing, batteries are to electric vehicles. Unlike with microprocessors, the U.S. share of lithium-ion battery production is tiny (*figure* E).

That's a problem. A new industry needs an effective ecosystem in which technology knowhow accumulates, experience builds on experience, and close relationships develop between supplier and customer. The U.S. lost its lead in batteries 30 years ago when it stopped making consumer electronics devices. Whoever made batteries then gained the exposure and relationships needed to learn to supply batteries for the more demanding laptop PC market, and after that, for the even more demanding automobile market. U.S. companies did not participate in the first phase and consequently were not in the running for all that followed. I doubt they will ever catch up.

The Key to Job Creation

Scaling isn't easy. The investments required are much higher than in the invention phase. And funds need to be committed early, when not much is known about the potential market. Another example from Intel: The investment to build a silicon manufacturing plant in the '70s was a few million dollars. By the early '90s the cost of the factories that would be able to

produce the new Pentium chips in volume rose to several billion dollars. The decision to build these plants needed to be made years before we knew whether the Pentium chip would work or whether the market would be interested in it.

Lessons we learned from previous missteps helped us. Some years earlier, when Intel's business consisted of making memory chips, we hesitated to add manufacturing capacity, not being all that sure about the market demand in years to come. Our Japanese competitors didn't hesitate: They built the plants. When the demand for memory chips exploded, the Japanese roared into the U.S. market and Intel began its descent as a memory chip supplier. Despite being steeled by that experience, I still remember how afraid I was as I asked the Intel directors for authorization to spend billions of dollars for factories to produce a product that did not exist at the time for a market we could not size. Fortunately, they gave their O.K. even as they gulped. The bet paid off.

My point isn't that Intel was brilliant. The company was founded at a time when it was easier to scale domestically. For one thing, China wasn't yet open for business. More importantly, the U.S. had not yet forgotten that scaling was crucial to its economic future.

How could the U.S. have forgotten? I believe the answer has to do with a general undervaluing of manufacturing—the idea that as long as "knowledge work" stays in the U.S., it doesn't matter what happens to factory jobs. It's not just newspaper commentators who spread this idea. Consider this passage by Princeton University economist Alan S. Blinder: "The TV manufacturing industry really started here, and at one point employed many workers. But as TV sets became 'just a commodity,' their production moved offshore to locations with much lower wages. And nowadays the number of television sets manufactured in the U.S. is zero. A failure? No, a success."

I disagree. Not only did we lose an untold number of jobs, we broke the chain of experience that is so important in technological evolution. As happened with batteries, abandoning today's "commodity" manufacturing can lock you out of tomorrow's emerging industry.

Wanted: Job-Centric Economics

Our fundamental economic beliefs, which we have elevated from a conviction based on observation to an unquestioned truism, is that the free market is the best of all economic systems—the freer the better. Our generation has seen the decisive victory of free-market principles over planned economies. So we stick with this belief, largely oblivious to emerging evidence that while free markets beat planned economies, there may be room for a modification that is even better.

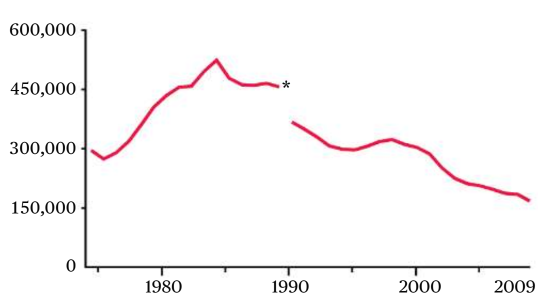
Such evidence stares at us from the performance of several Asian countries in the past few decades. These countries seem to understand that job creation must be the No. 1 objective of state economic policy. The government plays a strategic role in setting the priorities and arraying the forces and organization necessary to achieve this goal. The rapid development of the Asian economies provides numerous illustrations. In a thorough study of the industrial development of East Asia, Robert Wade of the London School of Economics found that these economies turned in precedent-shattering economic performances over the '70s and '80s in large part because of the effective involvement of the government in targeting the growth of manufacturing industries.

Consider the "Golden Projects," a series of digital initiatives driven by the Chinese government in the late 1980s and 1990s. Beijing was convinced of the importance of electronic networks—used for transactions, communications, and coordination—in enabling job creation, particularly in the less developed parts of the country. Consequently, the Golden Proj-

'Foxconn employs more than ... Apple, Dell, Microsoft, HP, Intel, and Sony combined'

Figure B

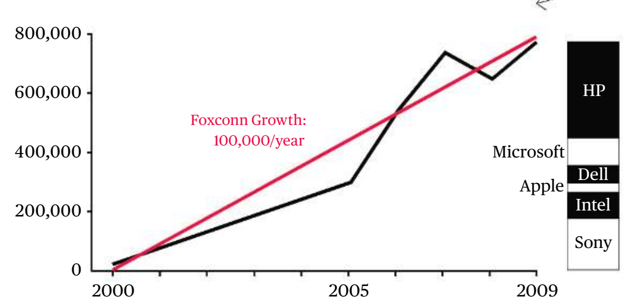
Computer manufacturing jobs in the U.S. have been on the decline since 1984*



* Before 1990; includes office equipment Data: Bureau of Labor Statistics

Figure C

Hon Hai (Foxconn) head count

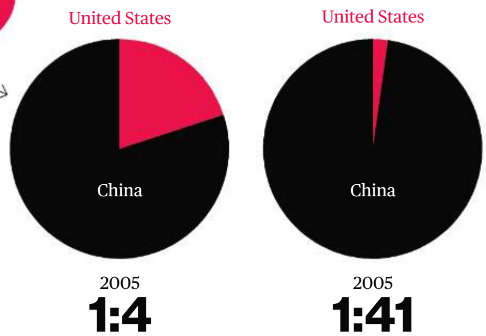


Data: Thompson Financial Extel Company Reports

‘What chips are to computing, batteries are to electric vehicles. The U.S. share of the battery market is tiny’

Figure D

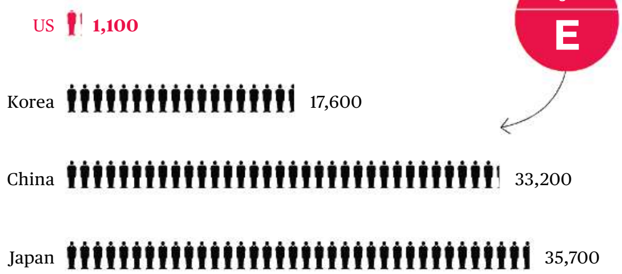
Ratio of solar production equipment sold into **U.S.** to units sold into **China:**



Data: Applied Materials

Figure E

86,500 people work in lithium-ion battery production:



Data: Intel

ects enjoyed priority funding. In time they contributed to the rapid development of China’s information infrastructure and the country’s economic growth.

How do we turn such Asian experience into intelligent action here and now? Long term, we need a job-centric economic theory–and job-centric political leadership–to guide our plans and actions. In the meantime, consider some basic thoughts from a onetime factory guy.

Silicon Valley is a community with a strong tradition of engineering, and engineers are a peculiar breed. They are eager to solve whatever problems they encounter. If profit margins are the problem, we go to work on margins, with exquisite focus. Each company, ruggedly individualistic, does its best to expand efficiently and improve its own profitability. However, our pursuit of our individual businesses, which often involves transferring manufacturing and a great deal of engineering out of the country, has hindered our ability to bring innovations to scale at home. Without scaling, we don’t just lose jobs–we lose our hold on new technologies. Losing the ability to scale will ultimately damage our capacity to innovate.

The story comes to mind of an engineer who was to be executed by guillotine. The guillotine was stuck, and custom required that if the blade didn’t drop, the condemned man was set free. Before this could happen, the engineer pointed with excitement to a rusty pulley, and told the executioner to apply some oil there. Off went his head.

We got to our current state as a consequence of many of us taking actions focused on our own companies’ next milestones. An example: Five years ago a friend joined a large VC firm as a partner. His responsibility was to make sure that all the startups they funded had a “China strategy,” meaning a plan to move what jobs they could to China. He was going around with an oil can, applying drops to the guillotine in case it was stuck. We should put away our oil cans. VCs should have a partner in charge of every startup’s “U.S. strategy.”

The first task is to rebuild our industrial commons. We should develop a system of financial incentives: Levy an extra tax on the product of offshored labor. (If the result is a trade war, treat it like other wars–fight to win.) Keep that money separate. Deposit it in the coffers of what we might call the Scaling Bank of the U.S. and make these sums available to companies that will scale their American operations. Such a system would be a daily reminder that while pursuing our company goals, all of us in business have a responsibility to maintain the industrial base on which we depend and the society whose adaptability–and stability–we may have taken for granted.

I fled Hungary as a young man in 1956 to come to the U.S. Growing up in the Soviet bloc, I witnessed first-hand the perils of both government overreach and a stratified population. Most Americans probably aren’t aware that there was a time in this country when tanks and cavalry were massed on Pennsylvania Avenue to chase away the unemployed. It was 1932; thousands of jobless veterans were demonstrating outside the White House. Soldiers with fixed bayonets and live ammunition moved in on them, and herded them away from the White House. In America! Unemployment is corrosive. If what I’m suggesting sounds protectionist, so be it.

Every day, that Palo Alto restaurant where I met the Chinese venture capitalists is full of technology executives and entrepreneurs. Many of them are my friends. I understand the technological challenges they face, along with the financial pressure they’re under from directors and shareholders. Can we expect them to take on yet another assignment, to work on behalf of a loosely defined community of companies, employees, and employees yet to be hired? To do so is undoubtedly naïve. Yet the imperative for change is real and the choice is simple. If we want to remain a leading economy, we change on our own, or change will continue to be forced upon us.

Churning Out Factories

High-tech manufacturing plants that make products such as electric-car batteries and LED lighting may create millions of jobs in upcoming years. Few of those jobs are likely to be in North America, where 49 chip factories have shut down since 2000. In the same period, Taiwan and China have built dozens. Many technology executives say the only antidote is government assistance, which has been far greater in other parts of the world. Now some U.S. officials are responding with subsidies and tax breaks, in an effort to combat high unemployment. Here's a look at three companies that are seeking to take advantage and create high-tech manufacturing jobs at home.

Detroit Power Play

As the U.S. economy unraveled in October 2008, Andrew Liveris, chief executive officer of Dow Chemical, asked his director of business development, Ravi Shanker, how they could create jobs near Dow's Midland (Mich.) headquarters, 130 miles northwest of Detroit. Shanker suggested that Dow make lithium ion batteries, the key component of electric-car engines. The Li-ion industry is expected to grow from $200 million to more than $25 billion by 2015, according to Needham & Co. In 2008, Asian companies had 98 percent of the market.

On June 21, Liveris broke ground on an 800,000-square-foot plant in Midland that will employ 800 people making 60,000 Li-ion batteries a year. It's owned by Dow Kokam, a joint venture created in 2009 with a U.S. partner that licenses technology from South Korean battery maker Kokam. Liveris is hoping Michigan's skilled workforce will be able to help it win business from companies such as Honda, Ford, and Tesla Motors, the electric-car maker that went public on June 28.

The deal was predicated on government support, as Dow Kokam received $161 million of the $2.4 billion the Obama Administration has earmarked for the electric-car industry. That covered half the cost of the 400,000-square-foot first-phase plant. An additional $180 million in Michigan tax incentives will help fund the second phase. "We would never have built it in Michigan, or the U.S., without that aid," Liveris says. "It takes some of the risk away from the investment."

Dow is using federal and state grants for a facility in town to make solar roofing shingles, employing an estimated 1,200 people. In addition to the 2,000 permanent workers at the two factories, Liveris believes the projects will create 14,000 jobs in local industries and services.

To make real progress, Liveris says the U.S. needs to cut corporate taxes and adopt an energy policy that promotes American-made alternative technologies. As a member of Thailand's Board of Investment, he advises the Thai government on how to craft the sorts of financial incentives he wishes were available in the U.S. "It's not a level playing field," he says. —*Jack Kaskey*



Bridgelux technicians make LED components in Livermore, Calif.



Chipmaker Globalfoundries' $6.6 billion site in Malta, N.Y.

FROM LEFT: COURTESY BRIDGELUX; BILL PUGLIANO/DOW CHEMICAL/AP PHOTO; COURTESY AERIAL DIMENSIONS

Funded by Abu Dhabi

When chipmaker Advanced Micro Devices announced it was getting out of the manufacturing business in 2007, people in Malta, N.Y.—a town of 13,000 that is 20 miles from Albany—worried about the fate of the massive plant AMD was planning to build there. Help came from an unexpected source: the government of Abu Dhabi.

The $6.6 billion, 300,000-square-foot factory project has been taken over by Globalfoundries, the company created when Abu Dhabi's Advanced Technology Investment bought AMD's plants in Dresden, Germany, and took over the Malta project. As in Michigan, subsidies were essential. New York State committed up to $1.2 billion in tax breaks and other incentives, depending on how many jobs the Malta facility creates. According to the Semiconductor Industry Assn., building a chip plant in the U.S. adds $1 billion in costs over its lifetime.

With both a state-funded nanotechnology research center and IBM's headquarters nearby, Malta has a healthy population of top engineers who are suited to this highly skilled work—which is part of the appeal for the company. (You try depositing a layer of chemicals that is one atom thick on a chip.) The jobs will pay well for the 1,300 people who will work there when the Malta factory opens in 2012. Dennis Mullen, chairman of the Empire State Development Corp., says his agency expects the project to create three or four times as many jobs outside the plant. —*Ian King*

The Costs Don't Work

When Bill Watkins took over Bridgelux in January, he hoped it would bring hundreds of jobs to the chip factory the company had just bought in Livermore, Calif., 40 minutes east of Silicon Valley. Bridgelux makes electronic lights based on the same light-emitting diodes that illuminate laptops and some flat-panel TVs—a technology that is expected to displace Edison's incandescent bulb as the core of the $100 billion-a-year lighting industry. All Watkins needed, he said, were some big customers, such as state or local governments, to commit to buying enough Bridgelux LEDs to get the business off the ground.

So far, Watkins has made "zero progress" on getting help for his Made in the U.S.A. plan. While senators, state officials, and utility executives talk about job creation, none has offered contracts that would allow him to add to the small crew of workers at his Livermore factory. Instead, he plans to move ahead with projects in China, India, Malaysia, and other places Bridgelux has been offered deals to retrofit streetlights or office buildings in exchange for creating local jobs. One Asian country—he refuses to say which, for fear of imperiling negotiations—offered to pay 80 percent of his workers' salaries for the next decade, along with a tax break, low-interest loans, and free land for the plant. Nothing in the U.S. comes close. "I think Bill's given up on the idea of volume manufacturing in the U.S.," says longtime friend Eli Harari, CEO of memory-chip maker SanDisk.

Watkins has seen this movie before. Until January 2009, he was CEO of Seagate Technology, the world's largest drive maker. To maintain profits in the face of falling prices, the company outsourced thousands of low-wage production jobs and, more recently, research and development positions. He had hoped Bridgelux would be different. With some minor incentives—such as a 10% premium over rock-bottom prices in a few big municipal contracts—he thinks Bridgelux could gain enough volume to compete with anyone. He would like to invest $150 million in the Livermore factory, in addition to $50 million already invested, and nearly triple its staff, to more than 350. The obstacle, he believes, is politics. While Americans want jobs, they want their low, low prices even more: "I'm going to spend the next year trying to find someone that is willing to pay to have something made in the U.S." When Watkins tells foreign government officials about his plans to boost American manufacturing, he says, "They laugh. Everyone knows the costs don't work."

Of course, Watkins isn't willing to mortgage his company's future for pure patriotism. He expects sales to double, to more than $60 million in 2011. "I want to create jobs here for my own personal reasons, but at the end of the day it doesn't matter," he says. "I can make Bridgelux successful wherever the jobs are." Ⓑ —*Peter Burrows*





Breaking ground on Dow Kokam's plant in Midland, Mich.



The Pragmatic Rebels

By Maureen Tkacik

The financial crisis blew a hole in big-think economics, raising the profile of a new breed of skeptical empiricists committed to assiduous testing and tangible results, no matter how tiny. Even lentils can lead to little miracles

Capitalists have devised countless ways to separate people from their money. Big-box retailers employ "markdown optimization" software. Chain stores break out the new seasonal collections right when the IRS sends out its first refund checks. Apparel brands release special "payday" promotional codes to online shopping sites on alternate Fridays. The behavior of the flush consumer is tracked far and wide.

Until Esther Duflo and a network of like-minded professors came along, no one spent much time tracking the spending habits of, say, Western Kenyan maize farmers.

Where buying power is minimal and retail sales figures don't exist to be analyzed, consumer behavior would seem a fruitless area of study. Duflo, 38, is an economist at Massachusetts Institute of Technology's Abdul Latif Jameel Poverty Action Lab (J-PAL). Last year she received a MacArthur "Genius" grant, and in April she won the 2010 John Bates Clark Award, considered a stepping stone to a Nobel. Yet her work is so minutely focused that its importance

PHOTO ILLUSTRATION BY TAMARA SHOPSIN AND JASON FULFORD



1 Lure of Lentils

When an NGO running mobile vaccination camps in rural Rajasthan, India, offered mothers in selected villages a free kilo of lentils for every immunization administered, vaccination rates for 1-to-3 year olds was six times higher than in villages where there was no intervention.



2 Seasonal Adjustment

Researchers in Kenya theorized that farmers who said they were too poor to buy fertilizer had just failed to plan ahead. To test this, they offered free delivery on fertilizer shipments to farmers who would commit to pay in advance. The following season saw fertilizer use increase by more than one third.

is not easily grasped at first glance. In 2000, Duflo and colleague Michael Kremer embarked on an extended inquiry into what was essentially a sales and marketing mystery: Why didn't the maize farmers of Kenya buy more fertilizer? Calcium ammonium nitrate was widely known to be effective on maize, the Kenyan Ministry of Agriculture officially endorsed its use, and market surveys conducted by a Dutch nongovernmental organization suggested that the product was held in high regard among farmers. Most expressed their intention to use it in the future, yet only 29 percent had done so the season before. Fertilizer represented the most important, logical, life-improving purchase these poor farmers could make. So why were so few of them buying it?

Working with the Dutch NGO International Child Support, Duflo, Kremer, and their then-assistant Jonathan Robinson (now an assistant economics professor at the University of California at Santa Cruz) ran a three-year experiment comparing the output of fields where the fertilizer was used to fields where it wasn't. On average, the fertilizer proved effective, but the cost-benefit analysis varied widely among plots. The official treatment recommended by the Ministry of Agriculture was unprofitable for most farmers, whereas halving the prescribed quantity and skipping the recommended hybrid seeds yielded a steady 70 percent annualized return on investment.

The first trial yielded a convincing advertisement for the virtues of fertilizer; 97 percent of the farmers told researchers later that they planned to use it next season. Only 38 percent followed through, and the team from MIT had an epiphany: When the farmers said they were too poor to buy fertilizer, they actually meant that they were temporarily broke. The money that came in after the harvest had been spent on other things before the next planting season arrived. An economist would describe the farmers as "stochastically present-biased."

Duflo had an idea: What if they got farmers to commit to buying fertilizer right after harvest, when they were still flush, by offering free delivery on their fertilizer shipments? The catch was that they had to commit their funds then and there. To gauge the program's effectiveness, they also monitored a control group of farmers who received no special offers. Finally, later in the season, they offered another group of farmers a straight-up subsidy, a 50 percent discount.

The results were striking: About a third of control-group farmers used fertilizer that season, vs. 45 percent of the farmers offered free delivery, and 46 percent of the discount voucher recipients. There was virtually no difference between the demand for full-price and half-price fertilizer if the full-price fertilizer was sold at the right moment. So between two effective policies with identical outcomes, one might cost three times as much as the other, all because of an irrational—and utterly commonplace—quirk of consumer behavior: the failure to plan ahead.

Closing the Last Mile

The case of fertilizer and the Kenyan maize farmer is, Duflo points out, a classic "last mile challenge," a term often used to describe the unwieldy work of getting broadband cables and DSL service to every last cul de sac in every last Zip Code. The situation is the same in Duflo's world, where numerous technologies have failed to reach needy end-users. From fertilizer to vaccines to mosquito nets and hand sanitizer, scores of low-cost innovations persistently fail to save or alter tens of millions of lives, either because they never reach the people who need them or the people who need them don't use them.

Closing the last mile is a matter of perennial debate in development economics. On one side are the macro-interventionists like Columbia University's Jeffrey Sachs, who frame the alleviation of poverty in Africa as a straightforward matter of diverting such an infinitesimal fraction of Western wealth to the continent that it is fundamentally myopic (if not immoral) to count shillings. On the other are libertarian-leaning economists like Bill Easterly and Dambisa Moyo who favor profit-motivated investments, like those increasingly made in recent years by Chinese sovereign wealth funds, as the best way to help the develop-

FROM TOP: PHOTO ILLUSTRATION BY TAMARA SHOPSIN AND JASON FULFORD; ILLUSTRATION BY ANDY FRIEDMAN



ing world. The interventionist's approach to Kenyan fertilizer is simple: subsidize it, generously. The libertarians—with whom the World Bank has officially sided on the issue since the 1980s—regard subsidies as the opiates of economic development. Between these two warring camps, there's Duflo and J-PAL, miniaturists committed to neither ideology, out there asking West Kenyan farmers how much money they have from one week to the next.

The Birth of the Randomistas

MIT is the undisputed capital of the "Lab." There's an AgeLab and Air-Sea Interaction Lab, a Humans & Automation Lab and a Distributed Robotics Lab, a Complex Systems Research Lab and the SENSEable City Lab. The Poverty Action Lab joined this lineup with little fanfare in 2003, when Duflo and two colleagues—Abhijit Banerjee, her former faculty adviser, and Sendhil Mullainathan, a 2002 MacArthur grant recipient—procured a $300,000 university grant to launch a research network dedicated to promoting and running "randomized control trials" like the fertilizer experiments.

"Ideology doesn't really matter so much," says Duflo, "when the objective is getting kids to show up for school or immunizing children"



Since then the lab has grown to comprise 46 "affiliated" professors from about a dozen schools who have together embarked upon at least 200 randomized trials in 33 countries, mapping the irrational judgments and hidden inefficiencies that sabotage efforts to help the poor. The mission is to test out a range of possible solutions and determine the one that works best for the money.

The appeal of J-PAL's experiments is that something almost always wins, and the relative differences are often surprising. While the boilerplate sex education lecture never had any meaningful impact on the sexual behavior of Kenyan teenage girls, a more specific lesson on the risks of being seduced by "Sugar Daddy" types within the 25-35 age bracket resulted in a considerable drop in teenage pregnancy and sexual activity across all age groups. When an Indian NGO organized mobile immunization camps in 30 villages to compensate for India's chronically short-staffed clinics, a survey showed that kids from those villages were nearly three times as likely as kids from control group villages to have gotten all their shots. But in 30 other villages, in which the NGO organized camps and offered moms a free kilogram of lentils for every vaccination administered, kids were more than six times as likely to be up-to-date on their shots—and the kids in neighboring villages all had compliance rates more than twice the control villages. Good policy, it turns out, promotes itself.

It's quite possible that no previous MIT Lab has ever taken its favored brand of scientific methodology as seriously as J-PAL takes the randomized trial. Such is the intensity of their faith in it that they're easy to caricature and have inspired a fair number of detractors. What will these tiny policy adjustments add up to? Impoverished children with all their shots will give birth to a new generation of impoverished children if rural India's policymakers fail to nurture new industries. But optimizing industrial development is not a matter of choosing between a few simple incentive programs you can compare in a randomized trial. So the "randomistas," as Duflo and her cohorts are sometimes derided by traditional economists, ignore the subject. "J-PAL economists can

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Take Your Medicine

TB kills more people every year than any other infectious disease besides HIV largely because people fail to take the full course of drugs. A study in Pakistan is testing whether the promise of free cell-phone minutes can increase drug adherence. Researchers are distributing urinalysis sticks engineered to reveal promotional codes redeemable for phone time when they detect TB drugs.



be disturbingly monolithic about their commitment to randomized trials as the source of intellectual discovery," says Harvard University political economy professor Dani Rodrik.

If J-PAL economists can be slaves to their methodology, even critics concede such focus is an understandable reaction to an era in which all economics seems ideological. Facts–the duller and more incontrovertible the better–are a critical weapon in driving policy forward. Plenty of economists hail J-PAL for leading a data-driven credibility revolution in a profession in which, as the labor economists Joshua Angrist and Jörn-Steffen Pischke recently observed in a paper, "Hardly anyone takes anyone's data seriously."

That the policy implications of a multiyear, hyperintensive randomized trial can often seem comically minor doesn't bother the randomistas, many of whom have spent their careers watching other economists make bold, sweeping, but ultimately ineffectual policy prescriptions. Duflo describes the J-PAL philosophy as "come on, we're trying to do one thing here, let's just do it. There are worse ways and there are better ways, let's just compare and evaluate them and pick the best one. Ideology doesn't really matter so much when the objective is getting kids to show up for school or immunizing children."

J-PAL practices economics for economists who have lost their faith in economics. Even Rodrik concedes that J-PAL's "low-impact" methodology of studying the economy is a reasonable reaction to a profession characterized by "a series of snake oil salesmen."

Ditching Stalin

Duflo was raised in the Paris suburbs; her father was a math professor and her mother a doctor who traveled regularly to Africa to volunteer in clinics. "I never experienced poverty–I grew up French middle class," she says. But from a young age she was made very aware of what poverty meant. "My mother would come back from Africa and show us slide shows of where she had been and what she had seen. She had this general sensitivity about it, the house was filled with books about poverty and public health, so that was kind of always in the background, and in the background I was always thinking, maybe I should try and do something about it, but not really having an idea how...."

Duflo was inspired to become an economist while working on an undergrad history thesis in Russia on Stalin's first Five Year Plan. It was 1993, and as she watched tanks storm the Parliament building to quell the rising dissent toward Boris Yeltsin's economic reforms, she had difficulty staying interested in Stalin and history in general.

At the time she was also working as a researcher for Jeffrey Sachs, then a celebrated Harvard economist on a USAID mission to advise the Russian government on managing the sudden transition from socialism to capitalism. Sachs had made his name administering a controversial brand of economic tough love dubbed "shock treatment" in Poland and Bolivia, but by 1993 he had concluded the Russian economy badly needed life support in the form of massive international aid. His pleas to wealthier nations fell on deaf ears, and as the economy worsened and chaos loomed, Sachs was increasingly drawn into vicious turf battles with his Russian-born Harvard colleague Andrei Shleifer. That fall, Boris Yeltsin sent tanks to storm the Parliament and quell dissent; by January, Sachs resigned and left Shleifer to helm the project.

"When the army attacked the Parliament, that was a really dark phase," remembers Duflo. "But at the same time, a lot of it was about economics and trying to get it right, and it collapsed with politics in a way that was interesting. Jeff Sachs had been making the point that much, much, much more money needed to be spent in Russia to avert a political crisis, and he lost that argument, but he may have been right. And I started thinking that economics as a discipline was a good way to understand the world and how all these things would play out. But I was also interested in a more extreme form, using what I learn to help Africa."

Duflo applied to economics graduate programs and enrolled at MIT

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the following fall. She knew she had made the right decision 10 minutes into her first class with Abhijit Banerjee, who had spent most of the previous decade formulating new theories for examining poverty to better account for behavior, psychology, negative feedback loops, and the quirks of the financial markets. "I was really in the right place at the right time," she says. "From the theory angle, a vast field was open for empirical work."

Banerjee had arrived in Cambridge as a 22-year-old Harvard PhD student in 1983, the same year as Sachs and Lawrence H. Summers, now director of the White House's National Economic Council, two of the youngest economists to receive tenure at the university. (Both were 28.) The laissez-faire Chicago School ideas popularized by Milton Friedman still dominated the field, but the clique of ambitious Harvard economists was determined to best them—and one another. Banerjee avoided the fray, though the Chicago School efficient markets dogma struck him, too, as preposterous. Markets, he believed, routinely failed for a variety of reasons, and he studied how extreme wealth and income disparities could lead to poverty traps that stifled the creation of a middle class. Corporations, he maintains, routinely undermine free-market competition. One paper Banerjee co-wrote with Summers investigated how even seemingly innocuous practices like frequent-flier programs exemplify systemic anticompetitive behavior.

Banerjee's work endeared him to Summers' protege Shleifer, a fellow skeptic of the efficient markets hypothesis. It was Shleifer who in 1991, freshly tenured and busy remaking the long-neglected development economics department, asked Banerjee if he'd try his hand at overhauling the curriculum. Shleifer would later be implicated in a scandal emanating from the consulting he did in Russia, precisely the kind of grandiose economics work that J-PAL would define itself in opposition to. "I suppose you could say we all share a sensibility formed in reaction to spending years in a field that is known to embody a certain, well...." Banerjee trails off. "I don't know if 'smug' is too cruel a word...."

The Next Generation

These days, J-PAL is nurturing a markedly different breed of economist, like Angela Kilby, 25, a research analyst who was planning to major in biology before she took Duflo's class in her sophomore year.



In the world of mainstream policy, says Banerjee, "trade-offs tend to be eschewed in favor of ubiquitous 'win-win' scenarios"

"Jeff Sachs had been making the point that much, much, much more money needed to be spent in Russia," says Duflo. "He lost that argument"



Kilby has been involved with one of J-PAL's most headline-grabbing innovations, X out TB, which distributes urinalysis strips among tuberculosis patients. When doused with urine containing tuberculosis-fighting drugs, the strips reveal hidden codes. Patients can then text the codes to their cell-phone providers and receive free minutes as reward for taking the medication.

Encouraging drug adherence is a sticky last mile challenge almost anywhere you go; some American clinics have taken to handing out computerized pillboxes that enter patients into a lottery in which they can win money when they remember to shake the box (and presumably, take a pill) once a day. TB is uniquely formidable because it requires a powerful cocktail of antibiotics that take at least six months to kill the disease—long after symptoms recede. As with any bacterial infection, a partial course of drugs is worse than no drugs at all, because it promotes antibiotic resistance, a big part of the reason TB now kills between 1.3 million and 2 million people every year.

J-PAL now attracts some of the brightest young minds in economics and is making its influence felt among the dominant institutions of the aid world, including the World Bank, which in 2006 asked Banerjee to serve on a panel that reviewed all the research it published from 1998-2005. Working with a team that included six other J-PAL economists, Banerjee encouraged researchers to be more transparent, noting wryly that "trade-offs tend to be eschewed in favor of ubiquitous 'win-win' scenarios, so that, for example, growth and environmental improvement are never seen as in conflict."

Sachs, too, has reached out to J-PAL. He has spent much of the past decade consumed with administering shock charity in Africa via the Millennium Villages project, in which 78 villages have received massive aid packages that effectively double the local economies overnight. Unfortunately for economists, Sachs didn't think about how the efficacy of the project could be measured until after all the villages had been blanketed with aid money. When he asked J-PAL last year for help evaluating the project, Duflo told Sachs that because the design of the project had not accommodated randomized testing, there was nothing she could do. B

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The Amazing Adventures of Tyler Brûlé

It's an editor (*Monocle*)... It's an ad man (Winkreative)... It's the high-flying expert on cities you'd love to visit ... oh, and he's found the perfect scarf
By Tim Adams Illustration by Gluekit

In a modest, terraced mews building beside Marylebone station in West London, the offices of *Monocle* magazine are, on the morning I visit, a little bleary eyed and blinking themselves awake. Several staffers are just back from a bonding and brainstorming weekend in Beirut, treating their jet lag with a variety of herbal teas. The air is thick with rose hip and ginseng. At the reception desk a scrubbed young man in impeccable casual wear is on the phone, putting a distant hotel booking desk through its paces: "All I want to know are the dimensions of your single room," he says. "I mean, is it an absurd space? We really do not want something absurd."

Tyler Brûlé, the founder, chief executive officer, editor, and guiding tastemaker of *Monocle,* is running late, but even in his absence you sense him in the detail of his compact and carefully styled offices. Brûlé made his name as the editor of *Wallpaper*, once the house bible of loft dwellers and metrosexuals everywhere, a magazine with the subtitle, "the stuff that surrounds us." Brûlé became famous for letting nothing escape his attention. His vision is built on stern principles, such as an emphasis on natural materials and a disdain for laminates of any kind. You look, in vain, for a veneer.

The latest edition of *Monocle* is a fat book of a magazine that challenges just about every piece of received wisdom about what works in media these days, starting with the notion that this is no time to start a new print publication. Now three years old, *Monocle* boasts a global circulation nearing 150,000, a 35 percent annual increase at a time when magazine sales are supposed to be going in the other direction, and a rising subscription base of 16,000. If that sounds small, consider that these individuals pay $150 for 10 issues, a 50 percent premium over the newsstand price.

For their money, readers get a compendious global mix of reports on new thinking and trends from unlikely places. They get the inside track on the "heroes of hospitality in Basel" and the "movie moguls of Mexico." They find out why "German doctors are the most attractive doctors in the world." There's more coverage than is possibly healthy about matters such as the comparative virtues of various overnight bags and calfskin slippers and monogrammed stationery. *Monocle* has, too, cornered the market on model cities, fantasy aircraft, and camp jokes. The cover I'm looking at advertises a feature on startups with a picture of a square-jawed warehouseman beside a stack of cardboard boxes, with the headline: "Is your package fit for global consumption?"

While I'm contemplating this particular question, the mood in the office sharpens. Brûlé's assistant makes a theatrical point of unlocking both of the tall double doors at the entrance and, swinging them open, hurries out to receive his boss's bag; Brûlé bustles in and heads straight upstairs. The editor is the son of a Canadian professional football player—Paul Brule (no accents), once of the Winnipeg Blue Bombers—and Virge Brule, an artist. Tyler has reemphasized those genes in interesting ways: He combines no-holds-barred career momentum with an aesthete's playfulness, stubborn business judgment with an entrenched place on *The Independent on Sunday*'s annual Pink List of the most influential gay people in Britain. He greets me with a linebacker's handshake and a somewhat ironic grin.

"If we can create a model where we have a journalist ... in the back and a shop selling our stuff out front, then great"

As soon as he's seated behind his desk, in carefully too-tight blazer and jeans, a just-so stubbly beard, and slightly oversized tortoiseshell specs, Brûlé is doing what he does best: pitching magazine philosophy, sharing trends from the cities that currently most excite him—Beirut, São Paolo, Seoul—talking about the opening party for a *Monocle* retail store/office in Hong Kong, and offering his response to the iPad: to publish a one-off, experimental newspaper for those who have no wish to take their technology to the beach.

Brûlé's magazine embodies the lifestyle he has been describing for the last six years in his widely read and often parodied "Fast Lane" column in the *Financial Times*. He likes to be thought of as a man who does much of his



Quotes taken from Brûlé's weekly *Financial Times* column



Journalist Brûlé is treated in Afghanistan in 1994 after being shot in an ambush



Wallpaper set tastes in the tech boom



Monocle defies digital trends

blue-sky thinking while above cloud level; his interests catch the slightly disconnected sense of scale that overtakes you on long-haul flights: He is passionately concerned both about hygienic headrests, say, and the Google-mapped chunk of earth that is passing 27,000 feet beneath; about business class china and the business class in China. In his world view, and in his magazine, all of these interests get pretty much equal billing.

In part, Brûlé discovered his philosophy while dosed up with morphine in a hospital bed in Afghanistan in 1994. He was 25, a freelance reporter working on an assignment with Médicins Sans Frontières in Kabul, when a jeep in which he was traveling came under machine gun fire. He was shot several times in both arms—his left remains pretty much useless—and, while recovering, had time to contemplate his priorities. He distances himself from hallucinogenic visions of angels bearing style magazines, but suggests that he did, lying there, come to see what mattered most to him. The list included "friends," "living in a great house," and "wanting to travel and see the world." The rest, he would argue, is magazine history.

Wallpaper helped define the tastes of the winners in the banking and technology booms. It combined an obsessive attention to the styling of household objects and hotel décor with an edge of distancing irony, a way of having it all. In 1997, after less than a year, Brûlé sold *Wallpaper,* begun on a shoestring budget, to Time Inc. for a reported $1.63 million. By 2004, when he left, *The New York Times* could describe "the *Wallpaper* generation" and have people understand what it meant; Brûlé, at 33, had received a Lifetime Achievement Award from the British Society of Magazine Editors. After some acrimonious clashes, Brûlé says he was fired by Time over an expenses claim for a London taxi, while others recall it as a chartered plane; either of which is a little like disciplining Homer Simpson for eating a canapé.

He took with him most of his key editorial staff and Winkreative, a branding agency that had grown out of the magazine. (*Wallpaper* is still thriving under Brûlé's former creative director, Tony Chambers.) At Winkreative, Brûlé had taken on the rebranding of Swissair in 2001 after its collapse—calibrating the look and feel of what became Swiss International Air Lines—and assembling a client list that ranged from BMW to designer Stella McCartney. He planned *Monocle,* envisioned as "a trendy *Economist,*" from the beginning, but competition clauses delayed its launch until 2007. The hiatus gave Brûlé a period to devise a new independent funding model. In the beginning he went to venture capitalists and private equity. They all said the same thing: If it is going to be something that drives Web numbers, then great.

"I got a bit tired of hearing from 24-year-old MBAs how the world of media was going to unfold," Brûlé says. "We had a Spanish client at the agency, and she came into the office one day. She is the Catalan matriarch of a family business, and she asked why there was a desk downstairs but no one working there. I told her about the idea for a magazine. She took the plan away and came back to say she would take 10 percent of the business on one condition: There had to be four other investors with similar stakes, they also had to run family businesses, and they had to be geographically diverse."

"People want to belong to something...Until an iPad is backlit, no one will have any idea that you read *Der Spiegel*"

Brûlé, never a man to shirk a challenge, came up with the appropriate investors from Australia, Sweden, Japan, and Switzerland. They now form the board and expect steady, if unspectacular, growth. The cultural differences and familial spirit, are, he believes, indicative of *Monocle*'s DNA. "They all had very different ideas of this global consumer we were talking about," he says. "We want the 19-year-old political science student or design student, as well as the investment banker or diplomat."

He is reluctant to disparage *Wallpaper,* still owned by Time, but does suggest that *Monocle* is for an audience that might have grown up with him. "After 2001," he says, "the international reader changed dramatically; travel became more complex, but more people began leading transborder lifestyles."

Although the soul of the magazine is, he says, mostly European, Brûlé finds himself increasingly drawn to the Far East. His passport reveals four times as many stamps from Hong Kong and Korea as from the U.S. "Asia is much more editorially interesting for us," he says, "and their companies and brands want to do more dynamic things." (By way of example, Brûlé mentions in passing that Winkreative has just won a contract "to rebrand the country of Taiwan.")

He sees himself as a salesman of ideas, and in this respect is relaxed—critics would say overly so—about the wall between the magazine and the agency. "Traditionally," he says, "editorial and advertising were always distinct in name. Church sat over here and state sat over there, but this is a new day. We are aware of potential conflicts but open to possibilities."

Although Brûlé does not run paid-

PREVIOUS PAGE: REX USA (2); ZUMA PRESS (2). THIS SPREAD: AFGHANISTAN: ZED NELSON/COURTESY MONOCLE; BRÛLÉ: DANIEL RIERA/COURTESY MONOCLE; COURTESY MONOCLE (5)





A retail outlet in Los Angeles

The London office of *Monocle*

Brûlé rebranded an airline



Brûlé in 2010



For shoppers: soap and an album

for "advertorial" features, he does sometimes work closely with commercial partners on particular stories. If the editorial obsessions of *Monocle* and the clients of Winkreative do overlap, he suggests his enthusiasm for a particular place or product naturally finds expression in both branches of his business, rather than that he uses one to cross-pollinate the other. Research in Motion, for example, has produced a $1,500 *Monocle* BlackBerry, and the company features heavily in the magazine's technology articles and sponsored podcasts. Singapore paid for a survey of the country. "Brands have been looking for better synergy and deeper relationships," he says. "In the past there was a lot of collusion in the background, I believe, between advertisers and editors. We are very clear where the boundaries lie."

One of the more unlikely ways in which Brûlé is looking to expand his operation is demonstrated at *Monocle's* new Hong Kong bureau. "We are financing that office by putting a *Monocle* shop out front," he says. The shop sells *Monocle*-branded items as well as selected goods from corporate partners like Japanese clothier Commes des Garçons, and of course, copies of the magazine. "We opened another in Tokyo two weeks ago. We are just taking a lease in New York. If we can create a model where we have a journalist, a researcher, and someone selling ads in the back, and a shop selling our stuff out front, then great."

Monocle, he says, has just turned a profit six months ahead of schedule. Given the fragility of the European markets, in particular, does he fear his readers might have more to worry about at present than, say, the highlights of this year's Milan furniture fair or which cars the Prime Minister of Malaysia has in his fleet? Brûlé points to a recent issue about entrepreneurs. "Our message is always that if you are not happy sitting at Deutsche Bank, there has never been a better time to pursue what you really want to do," he says. "We have a lot of correspondence from people saying that they had finally opened the gallery they wanted to open, or taken on that vineyard in New Zealand, or whatever."

His own biography exemplifies what might become a more insistent narrative. "We feel a bit like those Japanese companies," he says, "who don't expect double-digit growth but whose CEOs have far more fun going into the office every day than in the States."

Brûlé loves the counterintuitive and the freakonomical. In *Monocle*'s popular weekly podcasts he will champion the reemergence of Polaroid film to flout the digital revolution or promote the benefits of old-fashioned over online shopping. He places his faith in service rather than in technology. This intuition informs much of his decision-making.

"People are intrigued by how we manage to charge 50 percent more for subscriptions," he says. "Partly, the subscription gives people access to some *Monocle* extras, the website archive, and so on. But it is really based on the idea that people want to belong to something that says something about them." This is one of the reasons he remains skeptical about digital content. "People will choose what denim they want to wear, and they will choose what newspaper they want to buy, and they want other people to be aware of that, too. Until an iPad is backlit, no one will have any idea that you read *Der Spiegel* or the *Guardian* or whatever."

To back this belief, Brûlé is planning a one-off newspaper in the summer full of essays and reportage, all printed on luxurious paper. "It has already made a fortune in terms of advertising," he says. "But it brings up another thing. Would you take an iPad to the beach? To the pool? No. It's too precious. You can leave your newspaper on your towel and no one will nick it. And the thing about good newsprint is that it actually gets more tactile with a bit of sun and moisture." The code name for the paper is *Monocle-on-Med*; its distribution will be the coastal areas of Spain, Portugal, Italy, Egypt, Greece, France, and comparable spots in the U.S., such as The Hamptons.

The venture gets somewhere near the heart of what Brûlé is about: "Would I rather have a *Monocle* iPhone app than an office in São Paolo?" he asks rhetorically. "Absolutely not. I'd rather have the excuse to get out to Brazil."

A week later Brûlé is at a garden party in London to launch *Monocle*'s annual survey of the world's most livable cities. The party is populated with stylish Danish and Lebanese diplomats and groomed men in slightly too tight seersucker jackets. Beakers of rosé wine are brought around by younger men in what appear to be cricket whites. If they have one thing in common, I'd guess it's a shared belief that in general São Paolo is more appealing than an iPhone app.

The winner of the most livable city is Munich, which is a surprise not least to the representative from Hamburg, who has been asked to receive it. The German attaché struggles for the combination of criteria that might have led to the unusual choice. "Number of men in lederhosen?" he wonders out loud.

"You never know," says Brûlé, quickly. The German settles on Munich's reputation for being both rich and relaxed. He is talking *Monocle*'s language. Brûlé, who has been in California and Hong Kong since we last spoke, nods in approval and raises a glass to his world. **B**

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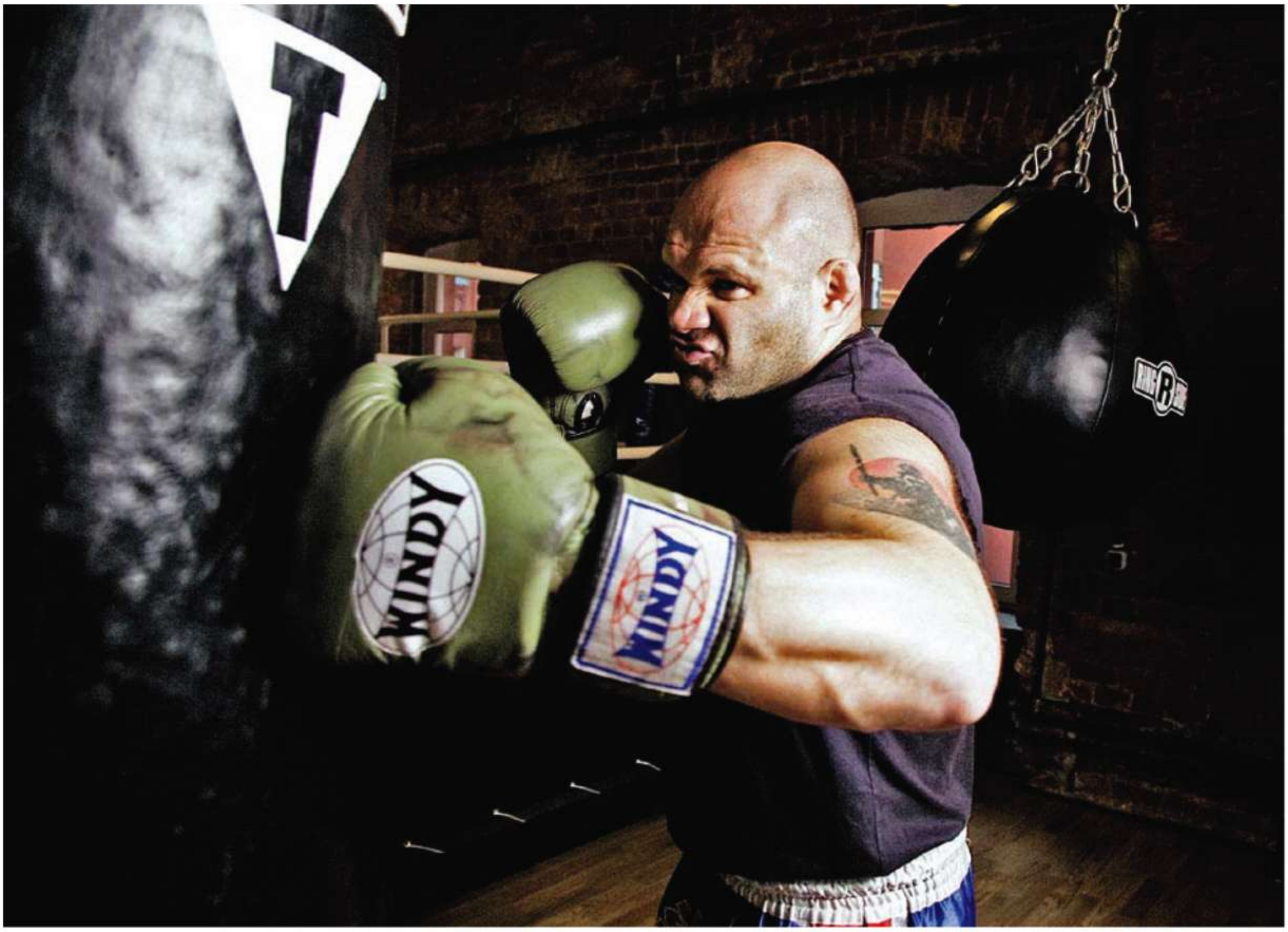
The uniform to wear while watching the World Cup. Page 77

Online Dating & Oil & T-Shirts & The Beatles

Etc.

Who's to blame for one of the worst management calls ever? (Hint: It's not who you think.) Page 78





From Russia with Gloves

Belonging to a swanky new boxing gym is the latest Western-inspired status symbol in class-conscious Moscow. *By Julia Ioffe*

Photograph by Anna Skladmann

TOP: WOLFGANG HEILEMANN/CAMERA PRESS

Etc. White-Collar Boxing

On a windy May evening, seven perfectly respectable, well-paid professionals—including two women—trudged up three flights of dusty concrete stairs in an abandoned Moscow factory and strapped on boxing gloves. For the next hour and 15 minutes they twisted and ducked, jabbed and cut, and sweated through their T-shirts as their hair turned to wet spaghetti. "I'll quit drinking, I'll quit smoking! I promise," one moaned, slinking, paunch first, out of the room and past the boxing club's owner, his wife.

"Get back in," she snarled. "Stop whining."

Her husband obliged, and Elena Molova went back to monitoring the class from the studio's doorway. It was the second day of operations at her October Boxing Club, a high-end boxing studio located on a thin island in the middle of the Moscow River and named for the now defunct, Soviet-era Red October Chocolate Factory next door. Tan, thin, and leathery—with a bob of peroxide blonde hair and vertiginous platform shoes—Molova is around 50 years old and has no prior boxing experience. (Her previous career? "Let's just say … construction," she demurred.)

About a year ago, in the throes of a financial meltdown that hit Russia especially hard—and hit its construction industry even harder—Molova sensed a trend wafting from the West. It started about a decade ago when Gleason's, the hallowed Brooklyn training ground for boxers, started admitting the occasional neophyte. The trend moved across the East River to Wall Street, where overpaid and overfed bankers, traders, and analysts began gathering in places such as the financial district's Trinity Boxing Club to release their competitiveness and, in some cases, vanquish their inner nerd. These soft-pawed bankers trained and competed in charity smackdowns that, during the good times, brought in as much as $100,000 a night. The trend quickly leapfrogged the Atlantic. From London, a city crawling with Russian expatriates, the hop to Moscow—where the sport remains popular from its 1930s proletarian heyday—was inevitable.

"These are slightly spoiled people. But here … your status means nothing," a trainer says

In a strange riposte to boxing's hardscrabble roots here, four gentrified clubs have opened in Moscow in the last eight months. All claim they are open to everyone, but they're actually targeting one particular demographic: men under 50 from the higher rungs of corporate management. "Our clients have achieved a certain stature in life—they know what they want," says Evgeny Tresko, a former boxer and the owner and manager of the Put' Boksera (Way of the Boxer) Club. "These are not people with too much time on their hands who just want a dumb fight. Of course, a couple of those types have shown up here. But they were intimidated by the prices and left."

As aspiring oligarchs seek out ways of differentiating themselves from other bourgeoise strivers, belonging to an exclusive club where only the wealthy can afford to pummel each other makes sense. "This is the most expensive equipment that exists in 2010," boasts one thirtysomething fighter at October, invoking the standard Russian metric for quality. The club is stocked with Johnson weights and Title gloves and punching bags. Says the fighter: "It's what Mike Tyson uses."

When it comes to price, this is not your mother's Russia—and that's the point. Way of the Boxer's one-on-one sessions can top $100 per class. And with membership at $2,000 per year, October's denizens are not your average street brawlers, either. Tatyana Arno, a TV personality, is a regular; so is Andrey Boltenko, the artistic director of Channel One, the main state-owned TV network. Filipp Yalovega, a Moscow hedge fund tycoon, usually rolls up on his Augusta motorcycle.

October is a favorite of Deutsche Bank employees as well as their counterparts at Merrill Lynch who work across the water. "The English and American guys just spar politely and break it up," says Eugenia Kuyda, Molova's daughter and a fighter herself. "The Russians—once you get gloves on them, you can't tear them apart. They are vicious."

That may be good news. Moscow's boxing club

Pugilists at Work



Bare-knuckle necessities for white-collar workers looking to unwind



Cleto Reyes Training Gloves

These pro-level, lace-up gloves ($150 at fightingsports.com) are supportive enough for heavy hitters and are known for their great fit.



Adidas Boxchamp Speed II Boot

The gold standard in boots ($150 at titleboxing.com), these kicks have 12-inch, lace-up shafts to protect ankles and shins.



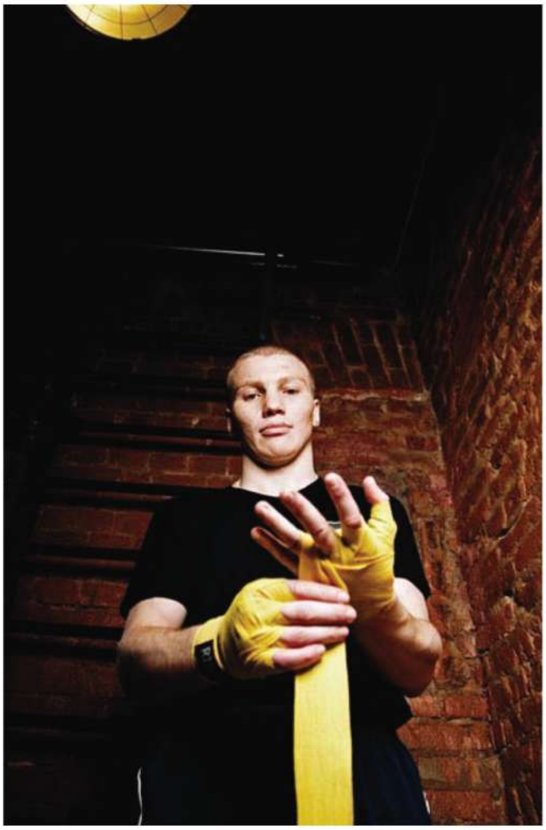
Everlast Competition Boxing Ring

Pining for a crowd? This ring ($7,950 at ringside.com) comes with a set of stairs, stools, and ring buckets.

ILLUSTRATION BY NISHANT CHOKSI







At the October Boxing Club: (clockwise from top left) Owner Molova; trainer Alexander Filichkin tapes up before a bout; Korreia works with a client

owners will tell you that the point of boxing is unprecedented fitness, but the real inspiration is reviving a masculine ideal that some feel is lacking in modern, corporate Russia. The empowerment of these wimpy, corporate technocrats is a challenge, and boxing appears to be a distinctly Russian solution. "It gives a man what he needs to be a man: to stand up for himself," says Tresko, hitting a common refrain. Behind the spread collars, lavish lunches, and hired women—so the theory goes—are fragile eggheads who studied hard, played chess, and paid for it in schoolyard gut punches. "What happens when a boy is attacked?" asks Kabi Korreia, a trainer at October club and a native of Guinea-Bissau who grew up in Russia. "He needs to fight back. It's wired into his nature."

In its first month in business, October Boxing Club has garnered about 50 regular clients. Molova is looking to eventually quadruple the number, launch a second gym, and, with the help of Moscow's government, open a children's boxing clinic in the fall.

"What's most important about boxing is it allows a man to not feel like a girl in a step aerobics class," Molova says amid the din of Russian gangster rap. "Boxing allows them to engage their masculine emotions. It's a way to prove himself, and it's nice to see men being men."

"The Russians—once you get gloves on them, you can't tear them apart"

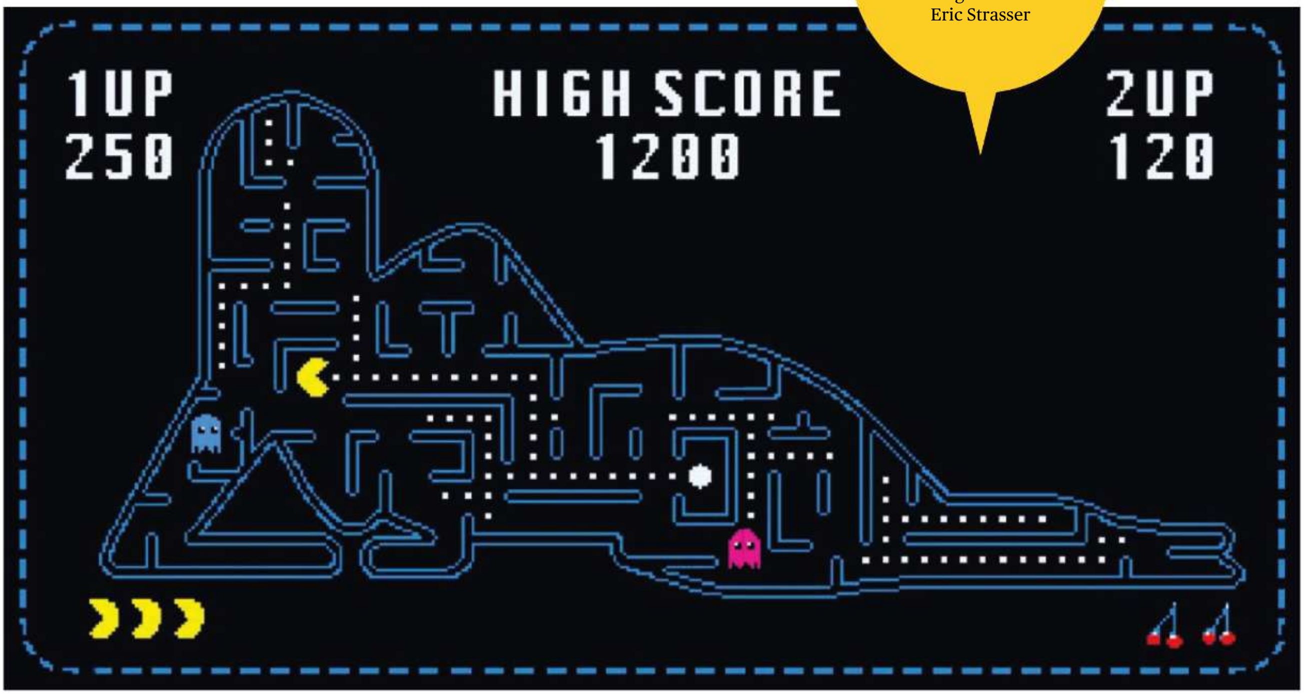
To that end, once they enter the gym, the nouveau riche suits are reduced to average citizens. "These are slightly spoiled people," Korreia says. "But here, when you walk in with your white collar, your status means nothing." This is not the first place Korreia has worked with doughy elites. Once, he personally trained a banker pushing 50. In two months, the client dropped 26 pounds and quit smoking. "I trained him like an animal," he says proudly.

As if on cue, three men walked in, one fat, one in a trench coat, one nondescript, all of them slightly menacing looking. They glanced around and watched the sparring a bit. Molova marched over to Yuri Koptsev, a bistro owner and former boxer who helps run the gym. "Who are these men?" she demanded. "Are they yours?" They were. Mr. Trench Coat, it turned out, was the deputy media director in the office of the all-powerful Moscow mayor. He was interested in taking classes.

With the more democratic fitness chains in Moscow offering more affordable boxing sessions, office drones all over the city just might start following the suits into the ring. By that point, though, the elites will have moved on to something different and more expensive. In modern, white-collar Russia, catharsis is important, but status is everything.

PHOTOGRAPHS BY ANNA SKLADMANN FOR BLOOMBERG BUSINESSWEEK

Only a small percentage of female "PlayDates" play "dirty games," according to co-founder Eric Strasser



The Newest Profession

GameCrush is part social network, part online dating site, and a lot of Grand Theft Auto

The most popular people at the annual E3 video game conference in Los Angeles last month weren't the creators of Nintendo's 3D handheld device or Microsoft's controller-free system, Kinect. They were, instead, the duo of Amber Syr and Gina Tran, two 21-year-old women who walked the showroom dressed in matching tight black short-shorts and tank tops that read "Play Me." Syr and Tran are "PlayDates" on GameCrush.com, a new Web site that offers predominantly male gamers a chance to do something many of them may not otherwise do: meet women. While playing video games.

The site, created by Bay Area friends Eric Strasser, 40, David Good, 35, and Anees Iqbal, 37, is part social network, part adult dating site, plus a heavy dose of Grand Theft Auto. There are now more than 1,000 registered GameCrush users, known as "Players," who can choose from a roster of more than 5,000 PlayDates, a mainly female constituency they can chat up through Instant Messenger or Web cam while gaming. (The registration process occurs online, without screening. However, all Players and PlayDates must be at least 18 years old.) PlayDates select whether they are "Dirty" or "Flirty," though Strasser says this function might change before the site comes out of private beta testing.

"PlayDates" Amber Syr, left, and Gina Tran make money by playing video games against men at GameCrush



Financially, GameCrush resembles a familiar, old-fashioned business model. In the beta version, gamers pay $4 for 10 minutes of playing with a companion on the Xbox Live system. They pay $4 for six minutes of playing online versions of casual games such as Battleship or Connect Four. (The online version charges an additional 60¢ for every extra minute.) GameCrush intends to split profits with the PlayDates, though Strasser says the pricing structure may change before the launch later this month.

Syr first discovered GameCrush by Googling "get paid to play video games." In a good week, she makes up to $150. Syr—who lists herself as "flirty"—says guys have been respectful. "Every now and then I'll have someone ask...," she says without elaborating. "I don't do the more risqué things."

Some people do. Strasser contends that GameCrush isn't a porn site for gamers. Only a small percentage of the women play "dirty games," he says. "You find yourself talking more about games—it's not just, 'You have a nice chest!'" Still, that happens. GameCrush does not monitor users' interactions. Its slogan: "Be a Player." Ⓑ —*Adam Satariano*

ILLUSTRATION BY JAMES GULLIVER HANCOCK

Etc. Wealth



← Invest in

Making Money Off Mother Nature

Ardour Capital's Walter Nasdeo unearths opportunities in alternative energy

I don't want to be ghoulish about the BP disaster, but it forces people to think about a different way of producing power without the risk of another Gulf disaster.

When oil prices rise, alternative energy is seen as a cheaper substitute and the stocks move up. When oil prices fall, alternative energy stocks lose their perceived advantage and fall, too. Right now the price of oil is down and alternative energy stocks have followed suit. The Ardour Global Alternative Energy Index is down about 27 percent from its recent high on Jan. 11.

The solar sector has lagged the broad stock market, partly because of economic issues in Europe. While the German culture is very environmentally sensitive, there is uncertainty over a subsidy to encourage alternative energy. In the U.S. we still don't have a well-thought-out plan to get money to solar. Billions are available, but solar companies are having a hard time getting that money. Government agencies are understaffed, and if something goes wrong in the application, it's bounced back and you have to start all over again.

However, as the alternative energy industry matures, some companies are breaking away from the pack. First Solar in the U.S. is the largest of the solar stocks, with a market capitalization of about $10 billion. It has a robust balance sheet—$1 billion in cash and $162 million in debt at the end of the first quarter. We think its stock could rise from 119 to 180 over the next 12 months.

China's Trina Solar, a low-cost maker of solar-powered products, has projected sales of $1.21 billion in 2010 and $1.4 billion in 2011, with earnings per share of $1.74 and $2.02, respectively. The company trades at around 18 and could reach 26 over the next year.

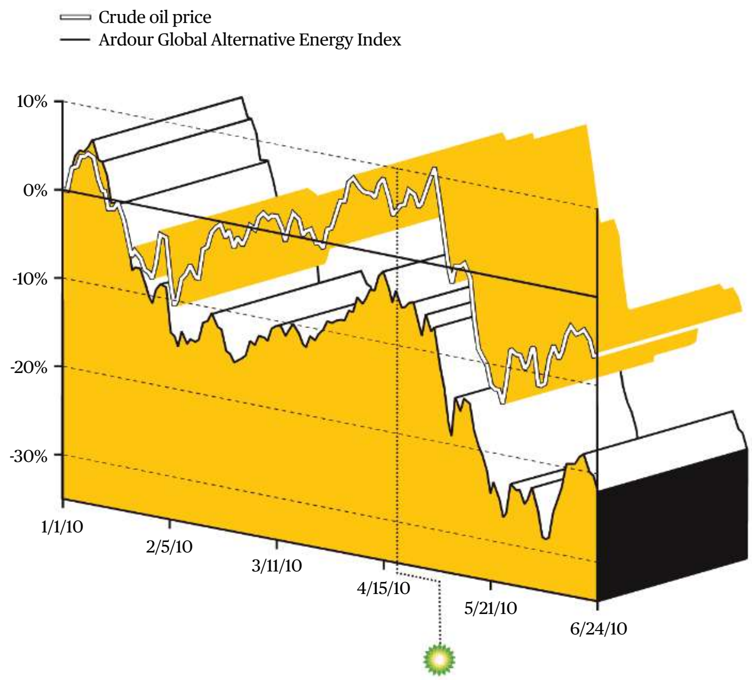
Alternative energy companies have traditionally been pure-play small-cap stocks. For those who want to take a chance, we like Beacon Power, which has a market cap of $60 million. Its technology offers superior energy storage to support the stability of electrical grids.

In the short term, I'm more optimistic about solar than wind; there's overcapacity in turbine manufacturing, which plays into the hands of the wind developers. Two wind stocks we do recommend are Germany's REpower Systems and PNE Wind, which trade on the Frankfurt stock exchange. REpower's year-over-year results show a 27 percent increase in operating earnings, and its gross profit margin is expanding. The stock could rise from €118 to €140 by mid-2011. PNE is a wind project developer, and its strong cash position gives it flexibility. Its stock could see a 70 percent jump.

The alternative energy industry is still young on the development curve. There have been fits and starts for many years. Today, we need the boost of subsidies. In a few years, we won't. —*As told to Christopher Farrell*

STRANGE BEDFELLOWS

Nasdeo notes that alternative energy stocks follow oil prices



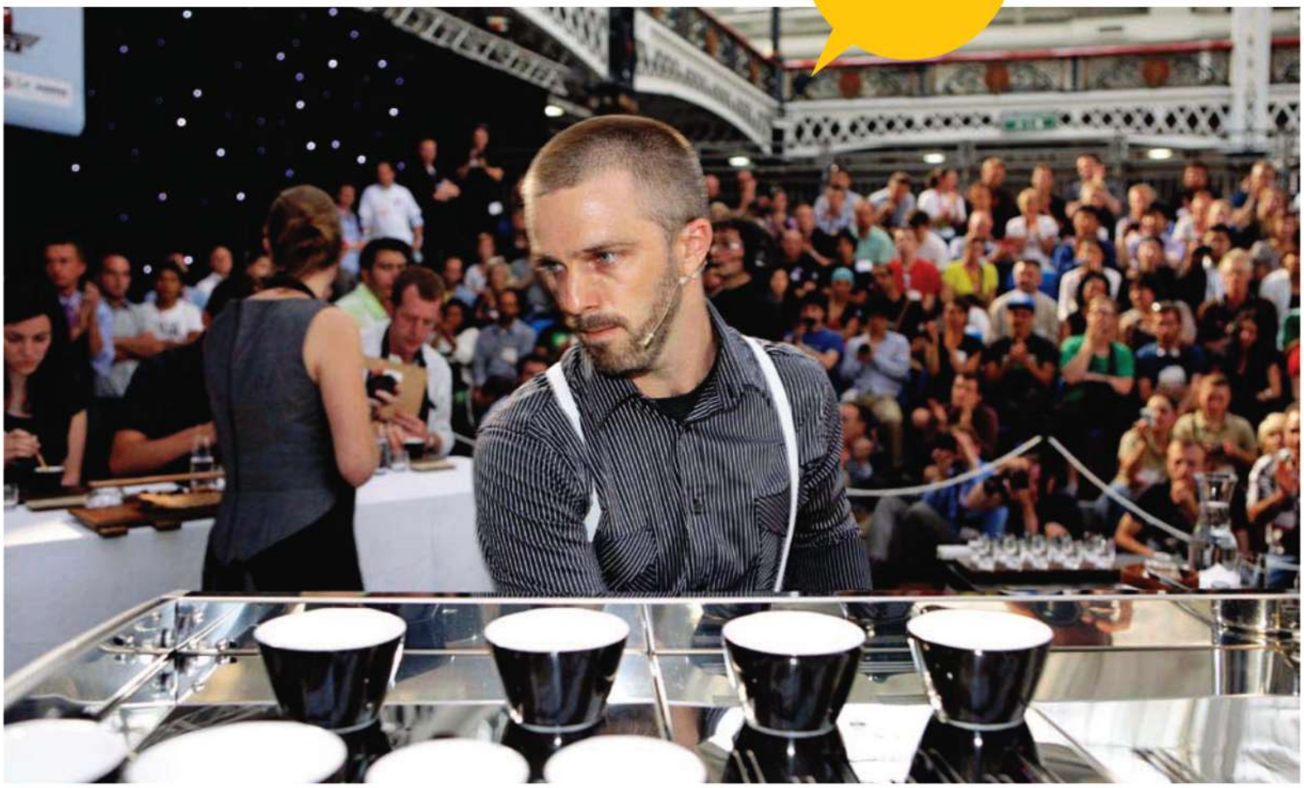
DATA: BLOOMBERG (AS OF JUNE 24)

First Solar and Trina Solar are breaking away from the pack

The Stats: Walter Nasdeo is managing director/director of research for Ardour Capital Investments, an investment bank specializing in alternative energy. Two of its five alternative energy indexes are tracked by exchange-traded funds—Market Vectors Global Alternative Energy and Market Vectors Solar Energy, both sold by Van Eck Global.

DIGITAL ZOO/CORBIS

Mike Phillips in the zone, at June's World Barista Championships



The King of Cappuccino

Barista Mike Phillips is leading coffee's "third wave"—to a store near you. *By Benjamin Wallace*

Last month, in an industrial neighborhood just west of Chicago's Fulton Market, Mike Phillips was fretting in "the lab"—a high-ceilinged room above the roasting plant of Intelligentsia Coffee & Tea. With only two weeks remaining before the 11th Annual World Barista Championships, Phillips, a two-time U.S. champion, was anxiously practicing his craft. As the second runner-up at last year's championship, Phillips was favored this time to defeat contenders from more than 50 other countries and win it all. Rather, he had been. One month earlier he had tripped and suffered a crippling injury—a broken pinkie.

Now, with the cast removed, the finger wouldn't bend, making it "immensely" harder for him to make latte art—the chiaroscuro rosettes and tulips with which high-end cafés adorn one's cappuccino foam. Phillips, 28, would have to limit himself to making hearts, the simplest frothed shape. "I'm having to relearn how to pour," he said, squeezing a wet, rolled-up towel as therapy.

Foamed hearts are considered the simplest form of latte art



Eleven years ago, when Phillips arrived at Northern Michigan University in Marquette, "I was a crap-coffee drinker," he says. "It was just fuel." Then an ambitious roaster opened a shop in town serving brewed-to-order single-origin beans, and Phillips got hooked. Even after he had graduated and moved two hours away, he found himself returning to buy coffee. He bought a $600 roaster, a $600 grinder, and a $1,700 espresso machine. Until he landed a job hauling sacks at Intelligentsia, in 2006, he had trouble getting barista work. He was "too scary," he says, for neighborhood cafés. "People wanted a cute girl with a nose ring"—not someone prone to giving a 10-minute tutorial on bean origins.

Intelligentsia was different. In the specialty coffee world, the Chicago-based company is a powerhouse. With its eight boutique cafés around the country, it's an innovative industry leader at the fore of coffee's so-called third wave. If the first wave meant canned Folgers from the supermarket, and the second was the relatively gourmet experience offered by Starbucks, the third goes further

PHOTOGRAPHS BY JUDE EDGINTON FOR BLOOMBERG BUSINESSWEEK

still, treating coffee like an *über*-artisanal product rather than a mass commodity. Phillips' devotion might sound a little zany, though paying $5 for a latte once did, too.

Phillips is now the company's assistant director of education, instructing its trainers and tasting a lot of coffee for quality control. Good coffee is a missionary calling for Phillips and his peers. He uses the phrase "coffee theory" in conversation and is helping to lead the movement to elevate coffee into the culinary repertoire. "It's the forgotten bastard child of cuisine," he says. These days, when he flies he brings his own beans, an airport-security-friendly hand grinder, and an AeroPress coffeemaker. He gets hot water from a flight attendant and brews an aromatic cup with his seat-belt fastened.

Barista competitions are one way of advancing the movement, though crowning the best barista is impossible, Phillips says, because the competition doesn't assess the less obvious skills. "Do you know how to throw out a crazy drunk man?" he asks. "Can you make it through four hours of nonstop service with good drinks?"

On this mid-June day Phillips was practicing a run-through of his competition routine. He would have 15 minutes to make four espressos, four cappuccinos, and four "signature drinks"—coffee concoctions of his own design. At the single-elimination event in London, two technical judges and four "sensory judges" would score him on a wide range of criteria, from the amount of coffee he wasted to the color of the crema on his espresso. Now, after "dialing in" the coffee—precisely calibrating a burr grinder's setting based on daily humidity and time elapsed since roasting—and setting the judge's table (water glasses, trays, spoons), it was time to begin. As R&B music played in the background, Phillips moved smoothly and efficiently, keeping up a patter about what he was doing. Whenever he turned away from the table to work at the espresso machine, stand-ins playing the role of judges emptied their water glasses. They were testing Phillips. Would he notice and refill them?

Phillips showed little rust. His espressos were creamy and intense, his cappuccinos rich, stiffly foamy, and topped with symmetrical, well-drawn hearts. But the true measure of an elite competitor is whether "you're trying to broach some concept and share an idea or experience." That's where the signature drink comes in. Last year his signature drink deconstructed an espresso, dividing a single shot into two different drinks—one based on the inky, chocolatey, more extractive first half of the pull, the other based on the lighter, juicier second half.

In preparation for this year's festival, Phillips had decided to focus on processing. While visiting Costa Rican supplier Coopedota in February, Phillips was inspired by the varied processing methods used (washed, natural, and honey), and came up with an idea for a new drink. He planned to make three drinks from the same bean, processed each of the three ways, as a study in how processing method influences bean flavor. The full-flavored natural bean—fermented in the sun with its skin on—would be mixed with a ginger-rhubarb reduction. The crisper, washed bean—stripped of pulp in water—would be combined with tart cherry juice and Pellegrino, resulting in a sort of coffee spritzer. For the third—a hybrid of the two methods—he would mix a sweet, honey bean with a date reduction. "I'm happy," he said, "because there's no chocolate and no milk, which are cheap shots."

Phillips had a hard time getting his start in coffee because "people wanted a cute girl with a nose ring"

Phillips finished the 15-minute drill with four seconds to spare. His performance went better than he had anticipated, although he saw room for improvement. "I think the second set of capps came in a little thin," he lamented. The date reduction was too thick to blend properly with the coffee; the ginger-rhubarb reduction had none of the sweetness he had hoped for—he thought he might have forgotten to add agave syrup. Also, he wished he had gone faster in order to have time to clear the pitchers at the end. "I've got a lot of work to do," he concluded.

Two weeks later, on June 25, Phillips won the world title in London, becoming the first American to do so. It would also be his last competition. Phillips' bosses at Intelligentsia, which has fielded four of the last five U.S. champions, have decided the company should step aside and give someone else a chance. Much of the once avant-garde coffee culture that Intelligentsia helped to pioneer has become the new normal among boutique roasters and cafés. Phillips and his colleagues are plenty busy just trying to figure out what's next. Ⓑ

Championship Cups

Next time you're looking for a jolt, consider a cup from one of these national- or even world-champion barista's shops.



Third Floor Espresso, Dublin:
A new downtown café helmed by Colin Harmon, the Irish espresso star famous for his originality. He took fourth place in the 2009 World Championship with a drink that included Morello cherries, crème anglaise, and seaweed.



Caffè Artigiano, Vancouver:
This café's baristas have dominated the national coffee scene for a decade. The group is led by Sammy Piccolo, who came out of retirement for the 2009 WBC. (His grapefruit-infused espresso helped him earn second place.)



Whitecross Street Food Market, London:
Flat-cap-clad 2009 World Barista Champion Gwilym Davies pulls shots at a freestanding cart in this daily food fair in Islington. Also on staff is James Hoffmann, who held the world title in 2007.



Costa Coffee, Budapest:
Hungarian star Attila Molnar—whose 2009 signature drink was made up of layers of toasted pumpkin seeds, maple syrup, and blueberry juice—trains the baristas at this British chain's location in Budapest.

Etc. One True Thing

Brigitte Bardot was the first to wear ballet flats on the street; hers were custom-made by Madame Rose Repetto

The Commuter Flat

Looking elegant on the way to the office

The Want: A pair of shoes to wear on the walk to work. They should go with any outfit, offer support, and fit into a handbag after the switch to a heel.

The Get: The Repetto BB Grey Patent Ballet Flats ($265 at Bergdorf Goodman). Their leather soles stand up to the daily commute, and the classic French shape is dressy enough for the office and whimsical enough for a night out. They're light, pack up nicely, and are made of shiny patent leather that won't stretch out or slide off of heels. Fashion before comfort? Forget it. Here's both. B —*Doria Santlofer*



CHICKEN SOUP FOR THE SOLE

Tips for avoiding walking-related injuries from renowned yogi Amy Matthews, who teaches a workshop called "Grounding: Feet Are Fundamental."



1. Beef up: If you wear ultra-padded shoes, you'll need to build foot muscles before walking in flats. Strengthen by spending time in bare feet and switching first to a medium-weight sole.



2. Pay attention: Feel every step flowing through the foot. Hit the ground with the heel, then send your weight to the pinkie toe and across to the big toe. This alleviates pressure in the knees and lower back.



3. Massage: Place a tennis ball on the floor, put your foot on top, and roll your arch and sole around on the ball. You'll stretch muscles and become aware of tight areas—so you can adjust your stride accordingly.

Based in Paris, Repetto has outfitted Frenchwomen in dainty but durable flats for 63 years

PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATIONS BY JAMESON SIMPSON

Etc. Next Life

Scoring on Soccer's Rich History

Ben Hooper left pro soccer and found his footing with retro-designed T-shirts

Hooper at his company's T-shirt printing warehouse in downtown Los Angeles



When Landon Donovan scored *that* goal to put the U.S. up over Algeria and his team into the World Cup knockout round, Ben Hooper was ecstatic. In 1997 he'd left college to play pro soccer, and he knew a number of the players on this World Cup team. He also knew Donovan's goal would be really good for his business.

Hooper, 33, played just one season in Holland before realizing that a long–and decently paying–pro career was unlikely. So he took a job at The Firm, a talent management company in Los Angeles, where he worked with Limp Bizkit, Korn, and the Backstreet Boys. Within six years, Hooper was looking for bands to sign and marketing megatours. But he missed soccer. He quit his job in 2004 and–along with a friend–created a soccer-themed T-shirt company. They named it Bumpy Pitch, slang for a rough playing field.

In the early going, the name proved all too apt. They had zero experience running such a business and, worse, no contacts in the industry. They couldn't even afford a designer and worked, themselves, on logos that were essentially no more than riffs on the company's name. The only interested buyers were their friends.

In 2008, Hooper changed his game plan by making T-shirts from scratch, forgoing buying up "blanks"–premade plain colored shirts–in bulk. He also hired a designer who helped propel the shirts in an increasingly popular retro direction. Hooper wanted to offer "a reminder of soccer's rich history in the U.S.," even if it was less a reminder than a primer for most.

It turned out there was a market for well-made $36 vintage garb. Shirts for bygone U.S. soccer teams such as the Bethlehem Steel and the Fall River Marksmen are consistently popular and appeal to die-hard fans–and their significant others, "who don't want their guys wearing a dumb-looking jersey," Hooper says.

Despite Team U.S.A.'s loss to Ghana in the round of 16, Bumpy Pitch just saw its most profitable month ever. Its blog, TheOriginalWinger.com, which links to its online store, has seen traffic more than double. (Adidas, Nike, and Puma have all approached Hooper about advertising.) "We've been waiting for a tipping point in North American soccer," Hooper says. "I don't want to go so far as to say this is it, but maybe it is?" —*Ryan Bradley*

Bumpy Pitch's Miami Gatos T-shirt



GETTING AN ASSIST FROM SOCCER MANIA

4,000
Hooper's 1997 monthly pro soccer salary in Dutch guilders (approximately $2,100)

140,000
Approximate average monthly number of visitors to Bumpy Pitch's website

$50
Monthly budget for the company's marketing expenses

400,000
Estimated visitors to Bumpy Pitch's website this past month

DATA: BUMPY PITCH

TOP: PHOTOGRAPH BY JEFF MINTON FOR BLOOMBERG BUSINESSWEEK

“The Beatles can’t save the world. We’ll be lucky if we can save ourselves,” said George Harrison

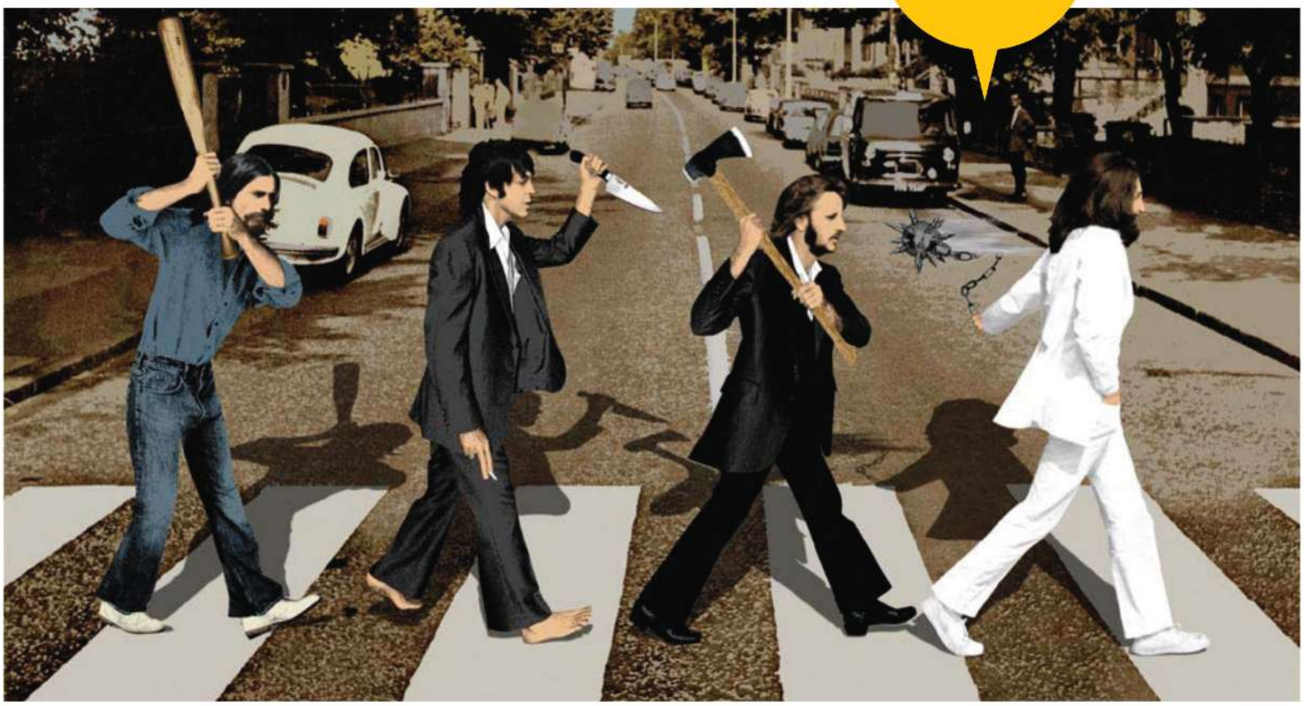


ILLUSTRATION BY JOHN RITTER

Could Anything Have Saved the Beatles?

Maybe–if management had kept out of their wallets and got inside their minds. *By Hugo Lindgren*

Of all the breakups across human history, the end of the Beatles has to be one of the most wasteful. Imagine what the Fab Four could have raked in over the years if they had behaved more like their rivals, the Rolling Stones, and not let their personal indulgences and adolescent resentments drive them apart. At the peak of their mutual disgust, the Beatles were world-famous multimillionaires in their late 20s, barely grown-ups in age and not at all in temperament. Their differences were surely heartfelt, but were they irreconcilable? Enlightened management might have kept them together.

As Peter Doggett demonstrates in his exhaustive, absorbing *You Never Give Me Your Money: The Beatles After the Breakup*, John Lennon and Paul McCartney fought over nothing and everything, like hurt lovers determined to inflict their pain on one another.

i

You Never Give Me Your Money: The Beatles After the Breakup

By Peter Doggett
HARPER; 390 pp, $24.99



George Harrison and Ringo Starr were, for the most part, bystanders to this blood feud, and would have been only too happy to be a part of a solution, if any of the Beatles handlers had ever thought to offer one.

Doggett throws ample light on the two dominant schools of thought about what caused Lennon and McCartney’s personal enmity. The leading one, of course, is the Evil Yoko Ono Theory, which holds that Ono, threatened by Lennon’s relationship with McCartney, did all she could to undermine the band, notoriously turning up for the recording of *The White Album*, sitting on top of an amplifier like it was no big deal. For this, Ono has been vilified by Beatles fans. But Doggett provides the context of utter craziness that helps us see her as more rational than nutso. A rock band is, after all, the best mechanism ever invented for mate acquisition, or, to use the slang, getting chicks. Once long-term mates are on the scene, they don’t much care for this dynamic and seek to intervene. Both Ono and Linda Eastman, McCartney’s girlfriend, then wife, were strong women who fought to stay close to the men they loved. Their actions, while not always laudable, are at least understandable.

Theory No. 2, heralded last year in a *Rolling Stone*

magazine cover story, blames the greed and dirty dealing of New York entertainment lawyer Allen Klein, who represented the Rolling Stones and eagerly filled the void left by the 1967 death of the Beatles' longtime manager, Brian Epstein. Klein promulgated an alliance of Lennon, Ringo, and George Harrison against McCartney, who preferred that Linda's family—her father was a lawyer who had represented Jack Lawrence, songwriter of Frank Sinatra's *All or Nothing At All* and Bobby Darin's *Beyond the Sea*—handle his affairs. In Doggett's account, Klein is a scoundrel, though ultimately an accessory to the band's demise rather than the trigger man.

Rolling Stone was right to see the problem as primarily one of adult supervision, or lack thereof. Like many celebrities, the Beatles were surrounded by two complementary species of sycophants —dope-addled hangers-on and money-sucking enablers. None understood the severity of psychological warfare that was going on in their midst. The creative rivalry that fueled the Lennon-McCartney songwriting partnership had come unhinged, as both men struggled to assert their independence. But they couldn't stop themselves from acting like children. Lennon's conduct, in particular, was so petty and embarrassing it's amazing he's remembered as a peace-loving martyr. He was the most resolutely opposed to reconciliation, so much so that McCartney felt obliged to do the same. "I can't just let John control the situation," he said, "and dump us as if we're the jilted girlfriends."

The actual grown-ups around the Beatles provided little guidance. George Martin, their beloved producer, was no more than a "kindly musical chaperon [sic]." Insofar as they did anything useful, Klein and Neil Aspinall (a former roadie who rose to be the custodian of Apple, the Beatles' holding company) focused on making deals, as if the personal conflicts were beside the point.

At times, *You Never Give Me Your Money* reads less like a book than a series of anecdotes about the Beatles' schemes to annoy each other. Which is another way of saying it's a lot of fun. What Doggett fails to do, though, is offer a singular diagnosis for what ailed the Beatles—or how they could have been saved. There's at least one fairly obvious strategy that went unplayed: hire a shrink. Lennon might well have been receptive to it. Described by Doggett as a "compulsive enthusiast," he was deeply devoted to Arthur Janov, progenitor of "primal scream" therapy. But he pursued it separately from McCartney and the band and, if anything, it fed his disaffection with them. What the Beatles needed was a neutral third party to help them understand that the band itself could be the psychological ballast in their lives.

Sampling The Band's Enduring Value



$1.2m

Amount an anonymous American collector paid for John Lennon's handwritten lyrics to the 1967 hit *A Day in the Life*, at a Sotheby's auction last month.



$562m

Amount grossed, according to *Billboard*, during the first five days of sales for *The Beatles in Mono*, a limited-edition box set released in September 2009.



$47.5m

Amount paid by Michael Jackson in 1985 for the publishing rights to a 4,000-song catalog including more than 200 of the Beatles' songs (*Love Me Do* and *Please Please Me* notably excluded).

Years later, such an intervention with a hugely popular rock band actually worked. In 2003, with Metallica on the verge of splitting up, the group's management hired a specialist to get the band members to open up about their feelings and figure out how to relate to each other as grown-ups. As depicted in the documentary *Some Kind of Monster*, the coach, Phil Towle, appeared to be a buffoon who did not actually have the psychological training he claimed, and the band united against him when they realized Towle had come to see himself as part of the band—a fifth Beatle, as it were. Still, the mere presence of an outside authority figure stripped the Metallica members of their celebrity delusions long enough to reacquaint them with the value of the group's identity. The band remains extraordinarily profitable, selling $53.4 million of concert tickets last year, the 10th highest among all bands, according to Pollstar.

Of course, money alone was too weak an incentive to keep the Beatles together. Although they disgraced themselves fighting over it, they always had plenty. Up until Lennon's murder in 1980, the Beatles were routinely offered giant sums to reunite, including a $30 million offer for a single album from David Geffen in 1974, which sounds like a ton of money even today.

Had they been less financially secure, the Beatles might have had no choice but to soldier on. That was the Stones' secret. As British music journalist Nick Kent describes in his recent memoir, *Apathy for the Devil*, Mick Jagger and Keith Richards couldn't afford their own Lennon-McCartney-style psychodrama. Around the same time the Beatles imploded, Jagger, writes Kent, "discovered that most of the money the Stones had made in the Sixties had been pocketed by manager Allen Klein along with all the rights to their recorded back catalogue." Jagger, who had dropped out of the London School of Economics when the Stones took off, had two choices before him: turn to drugs like Richards, or refamiliarize himself with numbers and guide the Stones into the black. "The guy chose to survive and thrive," writes Kent.

That line of thinking puts the onus of the Beatles' disintegration on McCartney. If only he'd agreed to let Klein control the band, they might have been driven into bankruptcy! Even Lennon had no interest in being poor. As it was, nobody involved in managing the band was smart enough, or brave enough, to force two immature, solipsistic young men on whom the entire enterprise depended into joint therapy. If that had been done, one of the worst managerial blunders in the history of the entertainment industry might have been averted. B

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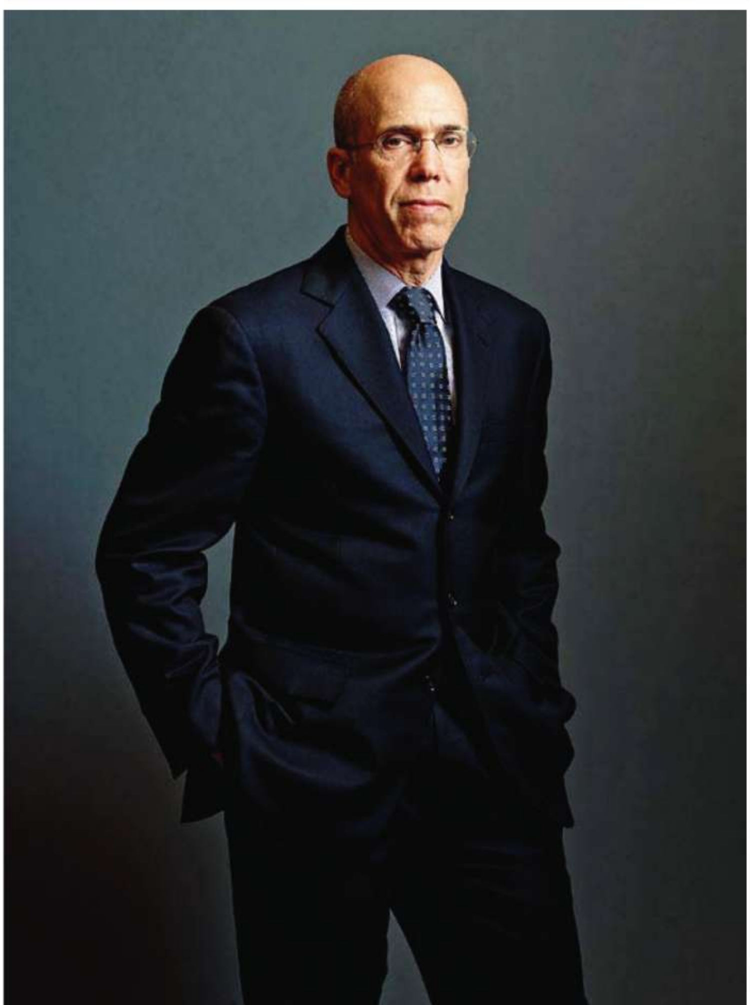
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Jeffrey Katzenberg

“What Michael had done to me was immoral, unethical ... I spent four years trying to get back what was mine.”

The DreamWorks Animation SKG CEO remembers being fired from Disney, suing Michael Eisner, and moving on



Sixteen years ago, Michael Eisner called me into his office and fired me. When he did, *The Lion King* was the No. 1 movie in America, *Beauty and the Beast* was a blockbuster on Broadway, and *Home Improvement* was the No. 1 show on television. Being fired in failure hurts. Being fired in success is downright humiliating. The most difficult decision in my career was made for me, instead of by me.

Disney put out a press release. When I got back to my office an hour later, I got three calls. The first was from Bill Gates. The second was from Tom Murphy, CEO of CapCities/ABC. The third was from Steven Spielberg and Bob Zemeckis, who were vacationing together in Jamaica. They called to congratulate me on getting fired. They thought it was hilarious.

I didn't see it coming. I felt as though I had given them the 10 best years of my ability to that point. I had had an 18-year partnership with Michael. We had shared a lot of triumphs and successes. I felt hurt that he chose not to continue the relationship.

Nobody likes to sue, but I had to. Numerous people tried to mediate this, but every single time, in every single way, it fell apart. What Michael had done to me was immoral, unethical. This was somebody who, out of anger, was trying to cheat me out of a black-and-white contract. I spent four years trying to get back what was mine at a cost of tens of millions of dollars. Everybody loses in some way when you find yourself in court.

I encourage people to make decisions as quickly as possible, to keep momentum; procrastinating causes a different set of problems. I tend to move on and not look back. But I can see now that the writing was on the wall at Disney. The way I was behaving was causing a level of friction I was unaware of. I wasn't thinking about my impact.

Even though I was angry, I walked off that studio lot with optimism. When we formed DreamWorks, David Geffen had sold his record company for the third or fourth time for another billion or two. Steven had done *Schindler's List* and *Jurassic Park*. And I had just been fired. —*As told to Diane Brady*

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